

Non-Federal Sovereign Wealth Funds in the United States and Canada: Public Asset Accumulation and Investment in Developed Economies

This abridged article was compiled by the authors for the print edition of *Revue Analyse Financière*, Q3 2014 (Issue N° 52). More detailed quantitative findings for this joint SLGE-WPC research project will be presented at the 4th annual World Pensions & Investments Forum held in Paris in October 2014.

DELINEATING SWFS BEYOND THE NORTH-SOUTH DIVIDE

Simply put, there is not one standardized definition for 'Sovereign Wealth Fund' (SWFs) and there often is much variation in the term's usage depending on socio-economic and cultural circumstances. Going back to the root meaning of "sovereign", from Old French *soverain* "lord, master", derived from Latin *super* "greater, above others" allows us to better understand the symbolic charge associated with this particular category of institutional investor. It is therefore no coincidence that the term first entered the academic and media mainstream around the time of the recent global recession. It was during this period that political science and economic works covered the potential economic decline in western developed economies, while at the same time continuing to note "the rise of the rest," as O'Neill et al. in 2005¹, among others, put it. Some wrote that the U.S. could potentially "lose control of assets to wealthier foreign funds"² whose

emergence "shake[s] [the] capitalist logic"³. This article will not seek to analyze the much-studied Asian and Middle East and North Africa (MENA) area government-controlled funds but instead will focus on state asset accumulation and investment in developed economies by covering key U.S. and Canadian non-federal sovereign wealth funds, whose foundation sometimes precedes that of their emerging markets peers, but have, until now, received far less attention from scholars and commentators.

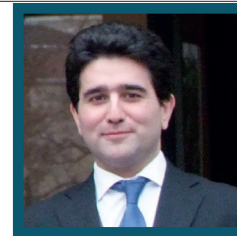
SWFs should be understood in a broader geographic and typological sense. Given this, this article refers to one of the definitions compiled by the U.S. Government Accountability Office in their 2008 report on SWFs: "[The US Department of] Treasury defines SWFs as government investment vehicles funded by foreign exchange assets that are managed separately from official reserves. They seek higher rates of return and may be invested in a wider range of asset classes than traditional reserves [...] SWFs generally

fall into two categories based on the source of their foreign exchange assets: commodity and noncommodity funds."⁴ This study summarizes some of the key findings of a joint SLGE-WPC research project on North American sovereign funds initiated in November 2013⁵.

ESTABLISHED U.S. STATE AND CANADIAN PROVINCIAL FUNDS

SWFs in the U.S. and Canada do not receive as much attention as those in other parts of the world for several reasons including, the relative size of their assets, the fact that the public entities that have established the funds in question are U.S. States and Canadian Provinces and Territories (not the Federal Government), that they are administered under established governance practices and norms, and the fairly limited scope of the uses for the funds held.

There are a range of SWFs in the U.S. in almost all regions of the country. For example, between 1854 and 2011, funds have been established in Alaska, Alabama, New Mexico,



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North Dakota, Louisiana, Texas, and Wyoming⁶. In the aggregate, the eight largest funds hold assets of about \$123 billion⁷. While these U.S. funds are generally smaller, in terms of assets under management, than some of the major, non-U.S. SWFs, the years of their founding precede or align with the establishment trends of the broader global SWF sector; examples include the Texas Permanent School Fund and French Caisse des Dépôts et Consignations being created in the early and mid-1800s⁸ to, more recently, the North Dakota Legacy Fund (2011) and the Western Australian Future Fund (2012)⁹. Looking forward, there continue to be policy conversations about establishing other funds as well, in California¹⁰ and West Virginia¹¹ for example. Also, with energy (notably natural gas in Southeastern Europe and shale gas in North America) production increasing in scope and size in many US states and other industrialized countries such as Cyprus and Israel, an uptick in the number of sovereign funds in developed jurisdictions, in some form, might be a realistic possibility. The Bank of Israel-managed Israeli sovereign investment fund (to be established end 2014) should start operating in 2016¹² after more than five years of preparatory work involving veteran American as well as local institutional investment experts¹³.

This section highlights four representative Northern American SWFs: three US and one Canadian that range in geography, size, structure, establishment year, investments, and other attributes: The Alaska Permanent Fund, The Texas Permanent School Fund, The Permanent

Wyoming Mineral Trust Fund, and the Alberta Heritage Savings Trust Fund. As will be observed, three of the funds considered (Alaska, Texas, Alberta) have notable allocations to “real assets” (land, property, infrastructure, commodities) and/or non-listed assets (such as private equity).

The Alaska Permanent Fund (APF) was established in 1976 by state voters through a state constitutional amendment and its funds are managed by a quasi-independent state entity, the Alaska Permanent Fund Corporation, established in 1980 by the state legislature¹⁴. As of the end of FY13 (30/6/13) the APF had about \$49.8 billion in assets (2013 APF Annual Report (AR), pg 29). At the end of FY12 and FY11 it held \$45.0 billion and \$45.2 billion in assets, respectively (2012 APF AR, pg 29). Fund income comes from a portion of Alaska oil and gas royalties and investments, with realized income used to pay dividend checks to AK residents (\$900 in 2013)¹⁵, provide inflation mitigation, and other purposes, determined by the state legislature¹⁶. According to its 2013 APF AR, the fund had an asset allocation of: 36% stocks; 21% bonds; 12% real estate; 6% private equity; 6% absolute return; 4% infrastructure investments; 2% cash; 2% public / private credit; and 11% other investments (pg 6). Within these categories were \$917 million in energy, transportation, water, waste management, and other infrastructure investments; \$704 million in distressed homes converted to rentals; \$1.3 billion in the distressed and subordinate corporate debt; among other types of nontraditional investments (2013 APF AR, pgs 16/18). In FY13, the fund

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had a 10.9% return (2013 APF AR, pg 5) and in FY 12 the fund return was -0.01% (2012 APR AR, pg 5).

The Texas Permanent School Fund (PSF) “was created with a \$2,000,000 appropriation by the Texas Legislature in 1854 expressly for the benefit of the public schools of Texas. The Constitution of 1876 stipulated that certain lands and all proceeds from the sale of these lands should also constitute the PSF. Additional acts later gave more public domain land and rights to the PSF”¹⁷. Later state, U.S. Congress, and U.S. Supreme Court actions allowed for Texas to allocate more land and related sale, rental, and natural resource income to the fund¹⁸. The fund has most of its assets managed by the State Board of Education, with additional land, real, and mineral assets managed by the School Land Board. As of August 31, 2013 the fund had \$30.9 billion in assets, up from \$29.4 billion in FY12 (2013 PSF AR, pg 17) and \$27.7 billion in FY11 (2011 PSF AR, pg 15), with an asset allocation of 44% in equities (29% US; 15% non-US); 15% US fixed income; 23% Alternative Investments (Absolute Return, Real Estate, Private Equity, Risk Parity, Real Return), and 14% in Land, Real Assets, and Minerals (2013 PSF AR, pg 63). The PSF annually distributes funds used for educational purposes to each school district in Texas and the fund also fills a guarantee function when schools borrow via municipal bonds (2013 PSF AR, pg 4). The portion of the fund managed by the State Board of Education had an overall rate of return of 10.16% for FY13 and 9.45% for FY12 (2013 PSF AR, pg 66).

The Permanent Wyoming Mineral Trust Fund (PWMTF)

established in 1974 by a state constitutional amendment¹⁹, is “Funded with constitutional and statutory mineral severance tax revenues, and occasional direct legislative appropriations. Income from the PWMTF goes to the state general fund”²⁰. As outlined on the Fund’s investment web site, the fund is managed by the State Treasurer whose office manages a quarter of the portfolio internally with the remainder being managed by private sector managers. At the end of FY13 (30/6/13) it held assets with a market value of \$6.1 billion with an asset allocation of 36% in equities (20.6% US; 15.8% non-US); 3% private equity; 4% real estate; 8% absolute return; 41% fixed income; and 8% cash (Wyoming State Treasurer’s Investment Report (WY IR) 9/13, pg 15). This market value was up from \$5.6 billion at the end of FY12 (WY IR 9/12, pg 17) and \$5.3 billion in FY11 (WY IR 9/11, pg 16). The fund had an overall rate of return of 8.19% in FY13 and 1.98% in FY12 (WY IR 9/13, pg 10). Fund documents refer to the more conservative nature of the asset allocation, which is linked to the state mandated 55% cap on equity allocations. According to the fund’s 2013 Investment Report, the state makes it a priority to offer loans to Wyoming organizations, across sectors. For example, at the end of FY13 the fund had extended \$118 million in loans to Wyoming farms, local governments, irrigation districts, and airports, among other entities and projects at rates of 1.50% to 7.75% (WY IR 9/13, pgs 2/32).

The Alberta Heritage Savings Trust Fund (AHSTF)

was established in 1976 by the Legislative Assembly of the Canadian Province of Alberta²¹ to “collect a portion [initially 30% but the actual share has varied widely in the past 38 years] of Alberta’s non-renewable resource revenue for future generations [...] the Fund’s net income has been used to support government programs, but a new savings policy announced on March 7, 2013 will see the Fund retain all of its income by 2016-17” (AHSTF AR 12-13, pg 4). The fund is managed by the Alberta Investment Management Corporation (AIMCo), a “hybrid” public pension and sovereign wealth asset management organization, which was spun-off by the province as a crown corporation

in 2008²². Most of the portfolio tends to be managed internally by AIMCo when it comes to public equity and fixed income, with relatively limited exceptions such as “niche” actively managed equity strategies. For infrastructure, private equity and timberlands, the fund invests both directly in assets (more than 50% of the total and most new investments) and through externally managed mandates. At the end of FY 13 (31/3/13) the AHSTF held assets with a market value of \$16.8 billion (CAD/USD being practically at parity on that date) with an asset allocation of 46.9% in listed equities (7.9% Canadian; 33.8% Developed non-Can., 5.2% EM); 6.4% private equity; 17.1% real estate; 0% absolute return and hedge funds; 19.9% fixed income; 6.0% infrastructure (transportation, energy infra and utilities), 3.4% “other assets” (split equally between private debt & loans and timber) and 0.3% cash. This market value was up from \$16.1 billion at the end of FY12 (31/3/12) (AHTSF AR 11-12, pg 1) and \$15.2 billion in FY11 (31/3/11) (AHSTF AR 10-11, pg 1). The Fund’s overall rate of return was 11.6% for FY13 and 8.2% for FY12 (AHSTF AR 12-13, pg 13). ■

FONDS SOUVERAINS D'AMÉRIQUE DU NORD : ACCUMULATION DE CAPITAL ET CHOIX D'INVESTISSEMENT

Cet article issu d'un projet de recherche euro-américain - World Pension Council (WPC) et Center for State and Local Government Excellence (SLGE) - présente les fonds souverains d'Amérique du Nord du point de vue de l'accumulation du capital et des politiques d'investissement des instances publiques (locales) des nations développées. En quelques années, les fonds souverains sont devenus des acteurs majeurs sur les marchés financiers.

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