



Research article

Sovereign wealth fund investments and the need to undertake socially responsible investment

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Abstract

There is an increasing consensus that, beyond financial returns, investors should also consider the environmental and social impacts of their business activities. Major institutional investors currently are entering the realm of socially responsible investment (SRI), which incorporates environmental, social, and governance (ESG) factors into decision-making based on internationally recognized standards and principles. As influential institutional investors, sovereign wealth funds (SWFs) have attracted attention worldwide and raised concerns from host countries. In this context, questions may arise, such as: Whether and why do SWFs need to undertake SRI? How to implement SRI strategies by SWFs? Can SWFs influence corporate performance through SRI?

This paper analyses the impact of SWFs in the realm of SRI and clarifies relevant legal issues concerning SRI initiatives by SWFs. It first examines the rationale of SRI and the reasons to implement SRI from theoretical and practical perspectives. It then questions the necessity to undertake SRI by SWFs. It discusses how to practice SRI based on examples of selected SWFs. It finally assesses relevant legal issues of SWFs' SRI actions. It concludes that SWFs can promote social responsibility and influence corporate governance of target companies to ensure their returns through SRI. But to be responsible investors promoting sustainability, SWFs ought to undertake SRI in line with certain legislative constraints or specific guidelines.

Keywords: Sovereign wealth funds, socially responsible investment, corporate social responsibility, corporate governance

Cite this article as: Yin W. Sovereign wealth fund investments and the need to undertake socially responsible investment, *International Review of Law* 2017:9 <http://dx.doi.org/10.5339/irl.2017.9.pp1-30>

1. Introduction

Traditionally, corporations and other institutional investors seek to maximize shareholder value by using diverse investment strategies. But placing emphasis only on the short-term maximization of financial returns may lead to such problematic issues as human rights violations, corruption, and undermining of environmental protection, amongst other issues. These problems exert adverse influences not only on social and economic systems, but also on the investor *per se*. Therefore, with a growing number of groups and organizations advocating sustainable development, institutional investors are turning to long-term value creation and sustainability via Socially Responsible Investing (SRI) to ensure financial performance and social returns.

Another significant phenomenon affecting global financial markets in recent years is Sovereign Wealth Fund (SWF) investment.¹ Even though SWFs are a heterogeneous group of institutional investors that have different governance structures and legal status, they are generally regarded as public entities that act like private investors in pursuit of financial returns.² They are owned or managed by governments, and they invest state-owned assets in financial markets to meet macroeconomic and social objectives. As the scale and asset accumulation of SWFs have increased, concerns have arisen that these funds have the capacity to undermine financial markets and national security if they use the political power of their home countries. But, in fact, SWFs could contribute to the stability of markets and economy growth if they are well organised and well regulated. Hence, the International Working Group (IWG) of Sovereign Wealth Funds, with the assistance of the International Monetary Fund (IMF), have drafted a code of conduct (the “Santiago Principles”) for SWFs to help reduce potential concerns and improve corporate governance.

Due to their public-private character, SWFs undoubtedly need to consider certain social returns when pursuing financial returns: they must be responsible for both their shareholders and their stakeholders. The counterparts of SWFs, other institutional investors such as mutual funds and pension funds, have already adopted SRI to some extent, and regulatory regimes are in place to encourage private entities to undertake SRI.³ Therefore, questions may emerge as to whether SWFs need to adopt SRI strategies and

¹See Simon Johnson, *The Rise of Sovereign Wealth Funds*, 44 FIN. & DEV. 1 (Sept. 2007), http://www.economia.puc-rio.br/mgarcia/Seminario/Seminario_textos/The%20Rise%20of%20Sovereign%20Wealth%20Funds.pdf.

²See Locknie Hsu, *Sovereign Wealth Funds: Investors in Search of an Identity in the Twenty-First Century*, 2015 INT'L REV. L.: SPECIAL ISSUE ON SOVEREIGN WEALTH FUNDS 1, 6 (2015).

³At the international level, many soft law regulations and internationally-recognized principles have been initiated for SRI or responsible investment. For example, the UN Principles of Responsible Investment, UN Global Compact, OECD (Organisation for Economic Co-operation and Development) Guidelines for Multinational Enterprises, Carbon and Water Disclosure Project, Global Reporting Initiative, Freshfields report (released by the United Nations Environment Programme Finance Initiative) and others are policy initiatives for corporations, multinationals, and institutional investors committed to conforming their corporate strategies to internationally-accepted principles and investing philosophies in the areas of environment, human rights, labour rights and other social factors. For more information about the regulation of SRI and responsible investment, please see Bryane Michael, *Corporate social responsibility in international development: an overview and critique*, 10 CORP. SOC. RESPONS. ENVTL MGMT. 115 (2003); see also Benjamin J. Richardson, *Keeping Ethical Investment Ethical: Regulatory Issues for Investing for Sustainability*, 87 J. BUS. ETHICS 555 (2009). At the national level, many jurisdictions include corporate social responsibility (CSR) principles in domestic regulations or policies, and the stipulations about the fiduciary duty of a company may extend beyond its shareholders and many groups have published guidance on CSR issues. For example, in the UK the Corporate Governance Code (and Turnbull Guidance) and the Companies Act 2006 require companies or directors to consider social issues. See *Corporate social responsibility – the UK Corporate Governance Code*, OUT-LAW.COM, <https://www.out-law.com/topics/corporate/company-law-and-corporate-governance/corporate-social-responsibility-the-uk-corporate-governance-code/> (last visited May 12, 2017). The Association of British Insurers has published CSR-related issues and SRI Guidelines highlighting ESG issues. See

how they will address the issues concerning ethical and financial returns. So far, few countries have imposed obligations on SWFs to invest ethically, and there is no explicit requirement that SWFs need to adopt SRI, even within the Santiago Principles. Nevertheless, some SWFs have been subject to regulations or policies to invest ethically and promote SRI to ensure financial and social returns by taking advantage of their ability to influence the corporate governance of certain companies.

This paper explores the relationship between SRI and SWFs. It particularly focuses on the necessity for SWFs to adopt SRI, and how SWFs can use SRI strategies to improve corporate social responsibility (CSR) and increase the impact of their initiatives on corporate governance. It begins by explaining the development and underpinnings of SRI. It then addresses whether SWFs should adopt SRI by drawing upon theoretical and practical perspectives. It investigates cases of SWFs in Norway, New Zealand, France, and Australia to help understand how SWFs can use SRI strategies to influence target companies and promote social responsibility.

While this article focuses primarily on the selected SWFs in the developed countries mentioned above, the implications of its findings may well have relevance for SWFs in other countries.

2. Rationale for responsible investment

In order to provide a basis for the discussion that will follow, this section reviews recent trends in SRI and analyses the underpinnings for SRI.

2.1 The trend of socially responsible investment

SRI—responsible, ethical investment—is an approach that acknowledges not only the role of financial criteria in investment but also the relevance of human rights, environmental effects, and other social factors, and then considers these factors in the decision-making process.⁴ Before approximately the mid-twentieth century, SRI was only a small-scale movement motivated by religious groups.⁵ The modern development of this investment philosophy was promoted by the civil rights, feminist, and environmental movements in the 1960s, and then by organizations such as the UK Sustainable Investment and Finance Association (UK SIF) and US Forum for Sustainable and Responsible Investment (US SIF) launched in the last decades of the twentieth century.⁶

Recently, environmental, social, and governance (ESG)⁷ factors have been stressed by the investment community. SRI has also been recognized by this community and adopted by many institutional investors,

Footnote continued

Association of British Insurers - *Guidelines on Responsible Investment Disclosure* (Jan. 2007), https://www.avis.co.uk/media/5893/ABI_RID_guidelines.pdf. In the United States, the U.S. Department of State undertook a comprehensive approach to supporting responsible conduct of corporations; hence, the Responsible Business Conduct (RBC) team was established in the Bureau of Economic and Business Affairs to promote ethical business practices. See U.S. Department of State, *Responsible Business Conduct*, <https://www.state.gov/e/eb/eppd/csr/> (last visited May 12, 2017).

⁴According to EuroSIF, sustainable and responsible investing (SRI) is a “generic term covering ethical investments, responsible investments, sustainable investments, and any other investment process that combines investors’ financial objectives with their concerns about environmental, social and governance (ESG) issues.” See EuroSif, *European SRI Study* (2010), http://www.eurosif.org/wp-content/uploads/2014/04/Eurosif_2010_SRI_Study.pdf.

⁵See Steve Schueth, *Socially Responsible Investing in the United States*, 43 J. BUS. ETHICS 189 (2003).

⁶See Ronald Paul Hill et al., *Corporate Social Responsibility and Socially Responsible Investing: A Global Perspective*, 70 J. BUS. ETHICS 165 (2007).

⁷ESG refers to a criterion to assess the non-financial behaviours and ethical impacts of corporations that is used by investors in a capital market.

especially investment funds.⁸ The financial market and regulatory problems revealed by the 2008 global financial crisis also have encouraged investors and policy-makers to consider long-term market development and relevant social externalities,⁹ considerations that also provide some support for the SRI movement.

Generally, SRI embraces three major strategies: (1) social screening; (2) shareholder activism; (3) community investing.¹⁰ Socially responsible investors may adopt one strategy or combine two or more of them. The majority of investors implement SRI through social screening and shareholder activism. Community investing is practiced mainly in the United States,¹¹ not in EU Member States, and will not be a focus of this article.

With social screening, investors invest in, or exclude, a particular company or sector based on its social record or ethical conduct.¹² Social screening includes two methods, negative screening (exclusion) and positive screening. Negative screening excludes or blacklists certain companies or sectors from investment based on ethical criteria.¹³ Positive screening¹⁴ involves preferentially investing in selected companies based on ESG criteria, which are often combined with the “best-in-class approach.”¹⁵ Positive screening mainly considers whether a company contributes to society or positively impacts social issues.

With shareholder activism, also known as “shareholder advocacy” or “relationship investing,”¹⁶ investors take advantage of their ownership rights to vote, engage in annual general meetings, or file shareholder resolutions, as appropriate, to promote the goal of improving corporate management and the ESG performance of a company. In other words, it aims to positively influence the conduct of a target company. Like social screening, it comprises two methods: one is active engagement, which seeks to

⁸According to the US SIF (US Forum for Sustainable and Responsible Investment), “The total US-domiciled assets under management using SRI strategies expanded from \$3.74 trillion at the start of 2012 to \$6.57 trillion at the start of 2014, an increase of 76 percent.” US SIF, *Report on US Sustainable, Responsible and Impact Investing Trends 12* (2014), http://www.ussif.org/files/publications/SIF_Trends_14.F.ES.pdf.

⁹See Benjamin J. Richardson, *Sovereign Wealth Funds and Socially Responsible Investing: An Emerging Public Fiduciary*, 1 GLOBAL J. COMP. L. 125, 129 (2012) [hereinafter, Richardson, *Sovereign Wealth Funds*].

¹⁰According to US SIF, community investing is defined as an approach that ‘channels public and private investment to low income and other underserved communities in order to provide capital, credit and training that these communities would otherwise lack.’ See *Community Investing*, US SIF, <http://www.ussif.org/communityinvesting>.

¹¹Community investing is strongly emphasized and implemented in the United States and promoted by US SIF. But in Europe, it is not regarded as a core approach for SRI strategies. See Céline Louche & Steven Lydenberg, *Socially responsible investment: differences between Europe and United States*, 1, 4 (Vlerick Leuven Gent Working Paper Series 2006/22).

¹²See Amir Bamea & Amir Rubin, *Corporate Social Responsibility as a Conflict Between Shareholders*, 97 J. BUS. ETHICS 71, 76 (2010); see also Alan Willis, *The Role of the Global Reporting Initiative’s Sustainability Reporting Guidelines in the Social Screening of Investments*, 43 J. BUS. ETHICS 233, 236 (2003).

¹³Negative screening may exclude companies undertaking unethical acts or posing risks related to ethical issues. It may also exclude investment in “controversial business areas,” such as nuclear power, alcohol, and the military. See Alexander Kempf & Peter Osthoff, *The Effect of Socially Responsible Investing on Portfolio Performance*, 13 EUR. FIN. MGMT. 908, 909 (2007).

¹⁴*Id.*

¹⁵See Luc Renneboog et al., *Socially Responsible Investments: Institutional Aspects, Performance, and Investor Behaviour*, 32 J. BANKING & FIN. 1723, 1728 (2008) [hereinafter Renneboog, *Institutional Aspects*]. The “best in class” approach or “best of class” model picks companies in each sector according to portfolio design. These companies are deemed as the most socially responsible investors in the corresponding industry. See KEN LITTLE, *THE COMPLETE IDIOT’S GUIDE TO SOCIALLY RESPONSIBLE INVESTING* 142 (2008).

¹⁶See Stuart L. Gillan & Laura T. Starks, *Corporate governance proposals and shareholder activism: the role of institutional investors*, 57 J. FIN. ECON. 275, 276 (2000).

directly influence a company's management through the use of voting rights and other shareholder rights, also known as "voice activism."¹⁷ The other method is divestment or "exit":¹⁸ investors divest a specific stock holding from their portfolio if a company violates ethical standards or internationally-accepted norms in areas such as human rights and environmental protection.¹⁹ Compared to other SRI strategies, shareholder activism is a more active way to influence the corporate governance in target companies.

Shareholder activism can be used by shareholders for either social or financial purposes.²⁰ "Social activism" has been practiced by private institutional investors via SRI for a long time. But the engagement of sovereigns in SRI through portfolio investment is a recent phenomenon.²¹ According to Ghahramani, sovereigns engage in SRI mainly based on three legislative models, one of which is ethics-based exclusion (e.g., Norway's SWF portfolio investment).²²

The method of SRI advocates is to influence corporate responsibility by showing that it has financial benefits; SRI encourages companies to "do well while doing good."²³ The concept of CSR emphasises the balance between shareholder value maximization and stakeholder value maximization. Even though economists and corporate lawyers have a sceptical view of CSR, it has become a heated topic and is discussed by various groups. Rational companies may voluntarily take measures to promote CSR because it can help improve corporate reputation and attract motivated employees.²⁴

The notion of SRI reflects the belief that "CSR and economic performance 'are not mutually exclusive but can be complementary,'" and can "mix the money with morality."²⁵ Apart from that, some investors use SRI strategies to influence corporate governance and thus ensure their profits in target companies. On the other hand, some investors prefer to invest in corporate governance systems with economic sustainability under which they can positively influence corporate operation.²⁶ In one study, corporate executives and institutional investors believed that CSR actions could help reduce the risks from unethical events and thus lead to economic value.²⁷ This study suggests that companies who implement SRI or who have better shareholder involvement would be more likely to add economic value and attract capital

¹⁷See Janet H. Marler & Christophe Faugère, *Shareholder Activism and Middle Management Equity Incentives*, 18 CORP. GOVERNANCE: AN INT'L REV. 313, 314 (2010).

¹⁸*Id.* at 316.

¹⁹According to Chung and Talaulicar, "exit activism" can be also described as "walk activism". See Huimin Chung & Till Talaulicar, *Forms and Effects of Shareholder Activism*, 18 CORP. GOVERNANCE: AN INT'L REV. 253,257 (2010).

²⁰See William Q. Judge, Jr. et al., *Antecedents of Shareholder Activism in Target Firms: Evidence from a Multi-Country Study*, 18 CORP. GOVERNANCE: AN INT'L REV. 258, 259 (2010).

²¹See Salar Ghahramani, *Sovereigns, Socially Responsible Investing, and the Enforcement of International Law through Portfolio Investment and Shareholder Activism: The Three Models*, 35 U. PENN. J. INT'L L. 1073, 1075 (2014).

²²The three models are "ethics-based legislative exclusion" (which is used by several home countries of SWFs), "nation-centric legislative exclusion" (which is used by American states), and "extra-legislative activism" (which is used by the California Public Employees' Retirement System-CalPERS, a state pension fund in the United States). *Id.* at 1075–83.

²³See Sally Hamilton et al., *Doing Well While Doing Good? The Investment Performance of Socially Responsible Mutual Funds*, 49 FIN. ANALYSTS J. 62 (1993); see also Todd Shank et al., *Doing Well While Doing Good" Revisited: A Study of Socially Responsible Firms' Short-term Versus Long-term Performance*, 30 MANAGERIAL FIN. 33 (2005).

²⁴See Renneboog, *Institutional Aspects*, *supra* note 15, at 1731.

²⁵See Terrence Guay et al., *Non-governmental Organizations, Shareholder Activism, and Socially Responsible Investments: Ethical, Strategic, and Governance Implications*, 52 J. BUS. ETHICS 125, 128 (2004).

²⁶See Shuangge Wen, *Institutional investor activism on socially responsible investment: effects and expectations*, 18 BUS. ETHICS: A EUR. REV. 308, 312 (2009).

²⁷See Henry L. Petersen & Harrie Vredenburg, *Morals or Economics? Institutional Investor Preferences for Corporate Social Responsibility*, 90 J. BUS. ETHICS 1, 13 (2009).

flows.²⁸ Therefore, the adoption of SRI seems to benefit both investors and investee entities (i.e. target companies).

2.2 Underpinnings for socially responsible investment

SRI potentially covers a range of investments and investors,²⁹ especially institutional investors, which includes SWFs and other investment funds.

From a practical perspective, first, external pressure and growing ethical trends could be an important reason to engage in SRI. Sustainable development³⁰ and CSR³¹ have been advocated by many international organizations, religious groups, and NGOs,³² all seeking to require multinationals and institutional investors to take social and environmental factors into consideration. Those investors, especially institutional investors, have faced increasing pressure from society and the media, and even governments, to consider social factors in investment selection,³³ to be accountable for the social impact of their investments, and to publicly report their investment decisions or responsible investment activities.

Empirical research has demonstrated that considering ESG in investment decision-making has become generally acceptable.³⁴ Some investment funds, e.g., mutual funds and large pension funds, have been increasingly participating in the realm of SRI groups.³⁵ Those investment funds have become increasingly concerned about the corporate governance of portfolio companies and the relationship between those companies and society.³⁶ Thus, those SRI investors undertake responsible investment to promote sound corporate behaviours.

Second, the growth of SRI groups can be partly attributed to changes in private regulatory regimes.³⁷ Public policy makers are increasingly aware of the importance of CSR and require corporations to take responsibility for general stakeholders and the society. At the national level, governments in many

²⁸*Id.* at 12.

²⁹SRI covers all types of investments including “direct share-ownership, mutual funds, hedge funds, private equity investments, private and national institutional pension funds, corporate bonds, sovereign wealth funds etc.” See Geoffrey Williams, *Socially Responsible Investment in Asia*, SOC. SPACE 20, 21 (2010), http://ink.library.smu.edu.sg/lien_research/62.

³⁰Even though it has many different meanings, in broad terms, the concept of sustainable development is an attempt to connect environmental issues with socio-economic issues. For more information about sustainable development, see Bill Hopwood et al., *Sustainable Development: Mapping Different Approaches*, 13 SUSTAINABLE DEV. 38 (2005).

³¹In the last decade, the evidence and practice show that there is an increasing number of corporations reporting on their social responsibility initiatives and undertaking socially responsible business practices. For more details about CSR, see Philip Kotler & Nancy Lee, *CORPORATE SOCIAL RESPONSIBILITY: DOING THE MOST GOOD FOR YOUR COMPANY AND YOUR CAUSE* (2005).

³²Many promising development activities undertaken by NGOs have emerged in many countries as well as in the international community. Implementing the concept of sustainable development cannot be well practiced without the assistance and advocacy of organizations and institutions. See L. David Brown, *Bridging Organizations and Sustainable Development*, 44 HUM. REL. 807, 808 (1991).

³³See Paul Cox et al., *An Empirical Examination of Institutional Investor Preferences for Corporate Social Performance*, 52 J. BUS. ETHICS 27, 27–28 (2004).

³⁴See Eva van der Zee, *Sovereign Wealth Funds and Socially Responsible Investing: Do's and Don'ts*, 9 EUR. COMPANY L. 141, 147 (2012) [hereinafter Van der Zee, *Sovereign Wealth Funds*].

³⁵For example, the California Public Employees' Retirement System (CalPERS) actively engages in companies to promote socially responsible performance. See Renneboog, *Institutional Aspects*, *supra* note 15, at 1726.

³⁶See Wen, *supra* note 26, at 310.

³⁷See Eva van der Zee, *In between two societal actors: The responsibilities of SWFs towards human rights and climate change*, 1 INT'L & COMP. CORP. L. J. 1, 22 (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925796 [hereinafter Van der Zee, *In Between*].

developed countries³⁸ have taken regulatory SRI initiatives to promote CSR, such as disclosure requirements designed for pension funds and listing companies in terms of social, ethical, or environmental related information.³⁹ Among these countries, the UK and the US governments positively support SRI activities, and the UK was the first country to regulate pension funds disclosing social, ethical, and environmental investment policies.⁴⁰

For example, the UK Pensions Act 1995 was amended in 2000 to require that trustees of occupational pension funds disclose in their Statement of Investment Principles the social, ethical, and environmental factors influencing investment decisions. In 2001, the Association of British Insurers (ABI) published disclosure guidelines directing listed companies to report social, ethical, and environmental risks in relation to their commercial activities. In US, the Sarbanes Oxley Act of 2002 stipulated ethics disclosure requirements in Section 406, which requires companies to disclose their code of ethics for senior financial officers.⁴¹

All these regulatory initiatives have positive impacts on the development of the SRI community. The reason governmental policies support SRI is that it helps governments “exercise a quasi-regulatory power over corporations without the direct intervention of government.”⁴² At the international level, the United Nations plays an important role promoting SRI or CSR via the U.N. Principles of Responsible Investment⁴³ and the U.N. Global Compact.⁴⁴ So far, over 1700 institutions have become signatories to the UN PRI,⁴⁵

³⁸For example, in Germany, occupational pension schemes and certified private pension schemes are required to report their investment considerations concerning social, ethical or environmental factors to the members. In Sweden, the Swedish national pension funds are required to include ethical and environmental considerations in investment policies. In Italy, pension funds are obligated to disclose non-financial factors that they consider in their investment decisions. In France, listed companies are required to publish social and environmental aspects in their annual reports according to economic regulations. In Australia, listed companies are required to make a separate annual report regarding social responsibility. See Luc Renneboog et al., *Socially Responsible Investment Funds*, in A HANDBOOK OF CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY 400 (Güler Aras & David Crowther eds. 2016) [hereinafter Renneboog, HANDBOOK].

³⁹See Renneboog, *Institutional Aspects*, *supra* note 15, at 1726.

⁴⁰See Renneboog, HANDBOOK, *supra* note 38, at 400.

⁴¹The “code of ethics” includes the standard to promote “honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships.” See Sarbanes Oxley Act of 2002, Section 406(c)(1), codified as 15 U.S.C. § 7264(c)(1).

⁴²See Louche & Lydenberg, *supra* note 11, at 10.

⁴³Signatories to the U.N. Principles of Responsible Investment (PRI) commit to putting responsible investment principles into practice, and the principles support the investors in incorporating these principles into their investment decision-making process. As of May 11, 2017, there are 1707 signatories of the PRI and more than 60 trillion dollars of assets under management. The six principles are as follows:

- Principle 1: We will incorporate ESG issues in to investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress toward implementing the Principles.

For more details, see *The Six Principles*, UN PRI, <http://www.unpri.org/about-pri/the-six-principles> (last visited May 1, 2017).

⁴⁴As a corporate sustainability initiative, the UN Global Compact aims at guiding and supporting companies to act responsibly and align their strategies with universal principles on social issues and take action for a more sustainable future. For more detail, see *What is UN Global Compact?*, <https://www.unglobalcompact.org/what-is-gc/our-work>.

⁴⁵The total number as of May 11, 2017 is 1704, which includes 343 asset owners, 1141 investment managers, and 223 service providers. Information available at <https://www.unpri.org/signatory-directory/?co=&sta=&sti=&sts=&sa=join&si=join&ss=join&q=> (last visited May 11, 2017).

and the UN Global Compact has 21,830 participants.⁴⁶ Even though these regulatory regimes are voluntary and in the form of soft law, many institutional investors (including several SWFs) have adopted or signed these principles and become a member of these groups. With the growing social awareness and increasing regulatory support, SRI will continue to expand.

Several theories help explain why SRI is expanding. The “universal owner”⁴⁷ theory may affect the decision-making of institutional investors, while the agency and stakeholder theories support why certain institutional investors adopt SRI to influence corporate governance. Sustainable investing is central to the “universal owner” (UO) theory,⁴⁸ which encourages investors to consider not only financial returns but also social influences. It is particularly relevant to SWFs due to their increasing size and assets, as well as their diversified investment portfolios.⁴⁹

The UO theory implies that if institutional investors take social and environmental externalities into their investment strategies, they will gain financial benefit from it.⁵⁰ For universal owners, they see not only the influence of target companies on their portfolio but also the overall long-term development of the financial market.⁵¹ It can be extrapolated that because these large institutional investors invest in a variety of assets across the economy, the social, ethical, and environmental impacts caused by target companies could threaten the economy as a whole. Therefore, these universal owners may make efforts, driven by purely financial motivation, such as exerting their shareholding rights, to directly create and ensure the financial value of their portfolio and thus indirectly promote the sustainability of the wider economy.⁵²

Yet the validity of the UO theory is in doubt by researchers because of several conceptual and practical difficulties.⁵³ It cannot reliably reflect or affect the operation of the economy and require what institutional investors should do. However, for general purpose, this theory can partly explain why institutional investors, especially the SWFs mentioned below, consider ESG issues when investing.

Secondly, both agency theory and stakeholder theory suggest that the ultimate goal of institutional investors' SRI actions and CSR performance is to maximize shareholder value.⁵⁴ In agency theory, the shareholders or owners are principals and the managers are agents. The agency relationship is defined as “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the

⁴⁶See *Our Participants*, <https://www.unglobalcompact.org/what-is-gc/participants> (last visited Jun. 9 2016).

⁴⁷The concept of *universal owner* is still under discussion and has not become a confirmed financial theory. See Roger Urwin, *Pension Funds as Universal Owners: Opportunity Beckons and Leadership Calls*, 4 *ROTMAN INT'L J. PENSION MGMT.* 26, 27 (2011).

⁴⁸A *universal owner* is an institutional owner that holds a diversified portfolio representing a cross-section of the economy and that considers long-term investment returns. Pension funds and mutual funds are examples of universal owners. See James Hawley & Andrew Williams, *Universal Ownership: Exploring Opportunities and Challenges: Conference Report* (Center for the Study of Fiduciary Capitalism, Saint Mary's College of California 2006).

⁴⁹See Benjamin J. Richardson & Angela Lee, *Socially Investing Without Legal Imprimatur: The Latent Possibilities for SWFs*, in *RESEARCH HANDBOOK ON SWFS AND INTERNATIONAL INVESTMENT LAW* 393 (Fabio Bassan ed., 2015).

⁵⁰For more details, see James P. Hawley & Andrew T. Williams, *THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC* (2000).

⁵¹See Urwin, *supra* note 47, at 26.

⁵²*Id.* at 27.

⁵³See Benjamin J. Richardson, *Socially Responsible Investing for Sustainability: Overcoming Its Incomplete and Conflicting Rationales*, 2 *TRANSNAT'L ENVTL. L.* 311 (2013); see also Herman E. Daly, *Allocation, distribution and scale: towards an economics that is efficient, just and sustainable*, 6 *ECOLOGICAL ECON.* 185 (1992).

⁵⁴See Wen, *supra* note 26, at 325.

agent.”⁵⁵ It means that shareholders, as principals, delegate the power to maximize return on financial capital while managers, as the agents, do not always represent the interests of shareholders, and their respective interests are not always aligned.⁵⁶ Hence a range of internal mechanisms and mandatory regulations exist to address the risk allocation between managers and shareholders. The board of directors is established to ensure that agents operate in the interest of shareholders.⁵⁷ When SWFs act as shareholders in target companies, they have the opportunity to influence the existing governance structure by forcing target companies to undertake CSR performance. Furthermore, investors can influence corporate governance as stakeholders. The concept of stakeholders mean those individuals and entities that can affect corporate business or in turn are affected by the company.⁵⁸ The stakeholder theory encourages investors to evaluate their relationships with target companies via business transactions, external intervention, or legitimacy claims.⁵⁹ If a company conducts CSR or undertakes responsible investment, it will bring about positive influence and social returns for its stakeholders. From the other side, stakeholders can promote SRI to influence the corporate behaviours.

However, the SRI philosophy may be doubted by some scholars. First, although companies that pursue CSR demonstrate higher shareholder value, “there is no convincing evidence on the direction of causality.”⁶⁰ Second, according to Ciochetti, some studies or investigations show that investors who adopt SRI are not able to gain a competitive return compared to the traditional profit-maximization⁶¹ because traditional investment strategies focus only on profit, and financial returns may achieve the planned objectives. Moreover, if investors cannot utilise or implement responsible investment well, they may achieve neither their financial returns nor desired social returns. Hamilton’s research demonstrates that socially responsible mutual funds do not outperform conventional mutual funds.⁶²

Nevertheless, ESG issues will increasingly affect economic and societal change, and they will be the key drivers for a healthy and stable market. For example, at the 2015 United Nations Climate Change Conference, the Paris Agreement – the first-ever universal, legally-binding global climate deal – was adopted by 195 countries.⁶³ It demonstrates that the issue of climate change is widely recognized by the international community, along with the need for sustainable economic development. Hence, in the future, investors who consider these ESG issues and effectively respond to these issues are likely to be the promising and successful entities in the market.

⁵⁵See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FINAN. ECON. 305, 308 (1976). For more information about the definition of agency relationship, see MING WAI LAU, *THE ECONOMIC STRUCTURE OF TRUSTS: TOWARDS A PROPERTY-BASED APPROACH* 54 (2011); see also MARKUS P. URBAN, *THE INFLUENCE OF BLOCKHOLDERS ON AGENCY COSTS AND FIRM VALUE: AN EMPIRICAL EXAMINATION OF BLOCKHOLDER CHARACTERISTICS AND INTERRELATIONSHIPS FOR GERMAN LISTED FIRMS* (2015).

⁵⁶See John Roberts, *Agency Theory, Ethics and Corporate Governance*, in *CORPORATE GOVERNANCE: DOES ANY SIZE FIT?* 252 (Advances in Pub. Int. Acct. No. 11, Cheryl R. Lehman et al., eds., 2005).

⁵⁷See Guay, *supra* note 25, at 130.

⁵⁸See R. EDWARD FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* 23 (2010).

⁵⁹See Guay, *supra* note 25, at 131.

⁶⁰See Renneboog, *Institutional Aspects*, *supra* note 15, at 1740.

⁶¹See Corey A. Ciochetti, *Socially Responsible Investing*, in *ENCYCLOPEDIA OF BUSINESS & SOCIETY* (Robert W. Kolb ed., 2007).

⁶²See Hamilton et al., *supra* note 23, at 62. They find that “socially responsible mutual funds do not earn statistically significant excess returns and that the performance of such mutual funds is not statistically different from the performance of conventional mutual funds.”

⁶³European Commission, Paris Agreement (entered into force Nov. 4, 2016), http://ec.europa.eu/clima/policies/international/negotiations/paris/index_en.htm.

Furthermore, several studies have found that there is a positive connection between social responsibility and financial performance in that social responsibility is associated with higher returns for investors (stock returns) and corporations (assets returns).⁶⁴ Indeed, several sources highlight that in the long term, the companies that take into account ESG factors and sustainable development in their strategies “significantly outperform their counterparts.”⁶⁵ Among academics and researchers who track and investigate companies or industries worldwide that undertake responsible investment, it is believed to be noncontroversial that SRI has the potential to promote social and ethical norms as well as regulations at the international level.⁶⁶

3. The need for SWFs to adopt responsible investment

In this section, we place SRI in the framework of SWF investments to discuss the need for SWFs to undertake responsible investment based on their unique position and characters.

3.1 *The phenomenon of sovereign wealth funds*

The rising influence of SWFs is one of the most significant developments in the international financial market over the past decade. As institutional investors, SWFs have attracted attention due to increasing size and assets invested in public and private equity. The Santiago Principles recognized the increasing influence that SWFs can exert over corporate governance practices and financial markets.⁶⁷

SWFs are established and funded by central or subnational governments, via balance of payment surpluses, to achieve financial or macroeconomic objectives.⁶⁸ Although SWFs are governmentally owned or managed, they are legally, financially, and operationally separate from other public assets and operate without future liabilities.⁶⁹ It should be stressed that SWFs are public institutions but operate financially in the international financial market with commercial guidelines and strategies.⁷⁰ SWFs are a complex and heterogeneous group of institutional investors, existing in various legal forms: as entities having separate

⁶⁴See Lammertjan Dam & Bert Scholtens, *Toward a theory of responsible investing: On the economic foundations of corporate social responsibility*, 41 *RESOURCE & ENERGY ECON.* 103, 115 (2015); see also Rients Galema et al., *The Stocks at Stake: Return and Risk in Socially Responsible Investment*, 32 *J. BANKING & FIN.* 2646, 2653 (2008). Apart from a study on listed companies in a developed market, one study, which investigated JSE-listed companies (Johannesburg Securities Exchange in South Africa), found that those companies complying with the SRI Index outperform non-compliant companies financially. See Ashley Mutezo, *Socially responsible investment and financial performance: evidence from the Johannesburg securities exchange*, 9 *BANKS & BANK SYS.* 120, 126 (2014), https://businessperspectives.org/media/zoo/applications/publishing/templates/article/assets/jjs/pdfs/web/viewer.php?file=/pdfproxy.php?item_id:5971.

⁶⁵See Robert G. Eccles et al., *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 *MGMT. SCI.* 2835, 2835 (2014).

⁶⁶See Jacob Park & Sonia Kowal, *Responsible Investing 3.0: Understanding the Environmental, Social, and Governance Context of Emerging Markets*, 2013 *GEORGETOWN PUB. POL'Y REV.* 17.

⁶⁷See International Working Group of Sovereign Wealth Funds, *Sovereign Wealth Funds: Generally Accepted Principles and Practices – “Santiago Principles”* (Oct. 2008), http://www.ifswf.org/sites/default/files/santiagoprinciples_o_o.pdf.

⁶⁸SWFs are established by governments for various policy purposes. Hence, there are certain subcategories within SWF groups, such as savings funds, development funds, stabilization funds, and reserve investment corporations. These policy purposes can influence the investment policy and management strategy of SWFs. For more details about SWFs, see *id.*

⁶⁹According to the Santiago Principles, the definition of SWF excludes traditional foreign exchange reserves held by monetary authorities for the purpose of balance of payments or monetary policy, traditional state-owned enterprises (SOEs), and government pension funds with future liabilities. *Id.* app. 1, ¶ 3.

⁷⁰See Massimiliano Castelli & Fabio Scacciavillani, *SWFs and State investments: A Preliminary General Overview*, in *RESEARCH HANDBOOK ON SOVEREIGN WEALTH FUNDS AND INTERNATIONAL INVESTMENT LAW* 9, 13 (Fabio Bassan ed. 2015).

legal identity with full capacity under public law;⁷¹ as state-owned corporations under general corporate law;⁷² or as a pool of assets without separate legal identity owned by a monetary authority or the government under specific rules.⁷³ Even though SWFs are institutional investors that share certain common characteristics, they are different from other institutional funds, such as pension funds, mutual funds, and hedge funds.⁷⁴ The definition of SWF is still under discussion, and individuals or organisations may provide their own understanding of SWFs with various purposes. There are, therefore, different definitions. In particular, there is no quite clear boundary between public pension funds and SWFs.

The huge amount of assets managed by SWFs and sovereign backgrounds raise geopolitical concerns from host countries⁷⁵ that SWFs may be utilised for political leverage⁷⁶ by governments of home countries over host countries, and thus control critical infrastructures. Fears that SWFs may threaten national security and market integrity also arise among host countries. Adding increasing uncertainty, a majority of SWFs do not disclose their information or report investment activities publicly, a lack of transparency that raises concern among policy makers. Therefore host countries are inclined to adopt strict legal response to SWFs or impose protectionist measures.⁷⁷ Due to the sovereign factor of SWFs, they are often regarded as SOEs (State-Owned Enterprises) and encounter restrictions similar to those designed for SOEs; sometimes, the harsh thresholds drive away SWF investments.

Nevertheless, some SWFs have earned positive reputations in the international community due to their high transparency,⁷⁸ sound corporate governance, and ethical investment policies.⁷⁹ These characteristics help reduce the concerns for host countries.⁸⁰

Even though fears and concerns exist as to SWFs' political motivations and the large amount of assets managed by SWFs, the positive influence of SWFs has been recognized by many scholars and international organizations.⁸¹ Specifically, SWFs, as long-term institutional investors, are beneficial to the

⁷¹E.g., KIA (Kuwait), KIC (Korea), QIA (Qatar) and ADIA (United Arab Emirates).

⁷²E.g., Temasek and GIC (Singapore), CIC (China).

⁷³E.g., GPF (Norway), FRF (Chile).

⁷⁴In the Santiago Principles, the definition of SWF excludes government-employee pension funds. Most public pension reserve funds have policies for socially responsible investments. See Adrian Blundell-Wignall et al., *Sovereign Wealth and Pension Fund Issues*, (OECD Working Papers on Insurance and Private Pensions No. 14, Jan. 2008), <http://www.oecd.org/finance/private-pensions/40345767.pdf>.

⁷⁵See Edwin M. Truman, Nonresident Senior Fellow, Peterson Institute for International Economics, Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs: Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications 14 (Nov. 14, 2007), <https://piie.com/commentary/testimonies/sovereign-wealth-fund-acquisitions-and-other-foreign-government-investments>.

⁷⁶*Id.* at 9.

⁷⁷See Roland Beck & Michael Fidora, *The Impact of Sovereign Wealth Funds on Global Financial Markets*, 43 *INTERECONOMICS* 349, 352 (2008).

⁷⁸According to the first-quarter 2016 Linaburg-Maduell Transparency Index (LMTI) ratings, developed by the Sovereign Wealth Fund Institute, 11 SWFs gained full points and are considered the most transparent SWFs. They are GPF (Norway), Alaska (USA), Australia Future Fund, Mumtalakat (Bahrain), AHF (Canada), NZSF (New Zealand), SWF in Azerbaijan, SIF (Ireland), Temasek (Singapore), Mubadala (UAE), and SWF in Chile. See Sovereign Wealth Fund Institute, *Linaburg-Maduell Transparency Index*, <http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/> (last visited Apr. 26 2016).

⁷⁹The representative SWFs that undertake ethical investment are GPF (Norway) and NZSF in New Zealand.

⁸⁰See Gerard Lyons, *State Capitalism: The Rise of Sovereign Wealth Funds*, 14 *L. & BUS. REV. AM.* 179 (2008).

⁸¹For example, OECD recognized the constructive contribution of SWFs to the economic development of their home countries and host countries. See Organisation for Economic Co-operation and Development, *OECD Declaration on*

global financial markets,⁸² especially during financial turmoil.⁸³ The outbreak of the global financial crisis in 2008 not only reminded the international community of the importance of a sustainable market,⁸⁴ but also provided SWFs the opportunity to step into the global market.

The increasing assets and size of SWFs have been acknowledged above. Although compared to the total global financial assets, SWFs may constitute a relatively small proportion, they are large enough that they can influence corporate governance practices and exert a stabilising effect on the financial market.⁸⁵ In fact, these large institutional investors can not only stimulate local and global economic growth and development; they also have the potential to positively impact human rights⁸⁶ and environmental situations⁸⁷ in host countries through investment activities such as responsible investment. On the other hand, for the same underlying reasons, SWF investments can also adversely affect social issues if they involve companies that violate environmental protection practices or engage in human rights abuse. Therefore, the choice of investment policies and strategies by SWFs can result in significant influences, both good and bad, on both target corporations and the global market.

As addressed above, due to pressure to manage profitably and responsibly, many institutional investors and multinationals have adopted or begun to implement responsible investments.⁸⁸ As a consequence of this development and the development and increasing influence of SWFs, the question arises as to whether SWFs need to adopt SRI strategies.

3.2 Why SRI works for SWFs

Because each SWF has its own specific governance framework and investment strategy, it is complex to undertake a case-by-case study. More comprehensive and empirical studies are needed in future to analyse the reasons for, and results of, SRI implementation by each SWF. Such studies might show that different governance frameworks, particularly concerning political involvement, may lead to differing financial performance for SWFs.⁸⁹ Due to the limitations of current research studies, however, this paper focuses generally on possible SRI underpinnings for SWFs, regardless of individual differences. In this light,

Footnote continued

Sovereign Wealth Funds and Recipient Country Policies (adopted June 4–5, 2008), <http://www.oecd.org/daf/inv/investment-policy/oecddeclarationonsovereignwealthfundsandrecipientcountrypolicies.htm>.

⁸²See Beck & Fidora, *supra* note 77, at 358.

⁸³See Philipp M. Hildebrand, Chairman Governing Bd., Swiss Nat'l Bank, *The challenge of sovereign wealth funds* (Jan. 21, 2008), <http://voxeu.org/article/challenge-sovereign-wealth-funds>.

⁸⁴See Richardson, *Sovereign Wealth Funds*, *supra* note 9.

⁸⁵See *Santiago Principles*, *supra* note 67.

⁸⁶See John Ruggie, *Protect, Respect and Remedy: A Framework for Business and Human Rights*, 3 *INNOVATIONS* 189, 195 (2008) (Report of the Special Representative of the United Nations Secretary-General on the issue of human rights and transnational corporations and other business enterprises, <http://www.mitpressjournals.org/doi/pdfplus/10.1162/itgg.2008.3.2.189>).

⁸⁷See Van der Zee, *In Between*, *supra* note 37, at 18; see also Van der Zee, *Sovereign Wealth Funds*, *supra* note 34, at 141.

⁸⁸See Sandra A. Waddock et al., *Responsibility: The New Business Imperative*, 16 *ACAD. MGMT. EXEC.* 132 (2002).

⁸⁹The result of Bernstein's study indicates that "funds, which are exposed to political influences, show major distortions from long-run return maximization." See Shai Bernstein et al., *The Investment Strategies of Sovereign Wealth Funds*, 27 *J. ECON. PERSP.* 219, 231 (2013).

it does appear that the common functional features of SWFs might lead them to practice responsible investment and support sustainability.⁹⁰

Many scholars and researchers argue that SWFs need to adopt SRI. This position is also reflected in the annual reports and investment strategies, as well as the activities of various SWFs, especially particularly influential SWFs.⁹¹ This article, taking the same position, sets out here various reasons why SWFs need to adopt SRI (apart from above-mentioned general reasons for implementing SRI by other institutional investors).

First, adopting SRI helps reduce the political concerns of host countries and avoids disputes caused by SWF investment activities. As various SWFs have invested in financial markets and strategic resources, host countries have been concerned that the activities of non-transparent SWFs might lead to illegal acts in capital markets and investing in sensitive industries (such as natural resources and military industry), with the goal of assisting SWF home countries to gain intelligence and thus undermine the national security of the subject host country. As a result, SWFs, especially those from China and Russia, have encountered resistance, suspicion, and even hostility from host countries.⁹²

The way to reduce concerns and improve the investment environment is to improve both SWF operation models, which include corporate governance, commercial operations, and transparency, and the use of SRI strategies by SWFs. These goals are interlinked. Regarding corporate governance and commercial operations, because SRI requires promoting social returns while pursuing financial returns, the operation of SWFs using SRI would be commercially-oriented. This orientation would require less political intervention and more professional managers within the corporate governance structure.⁹³ Lessening political influence should reduce national security concerns from host countries. Regarding transparency, most responsible investment guidelines and widely recognized principles require disclosure of social, ethical, or environmental information.⁹⁴ SWF adoption of this level of transparency would also reduce national security concerns.

Second, SWFs should adopt SRI in order to earn a favorable reputation. Both the SWFs themselves and their home countries would realize long-term benefits from this approach. Compared to other institutional investors, SWFs are unique due to the reasons for their establishment and their ties to the government.⁹⁵ If SWFs are involved in unethical investment, not only their reputation, but also that of their home

⁹⁰See Richardson, *Sovereign Wealth Funds*, *supra* note 9, at 127.

⁹¹Apart from the GPF and NZSF's practices for responsible investment, there are many SWFs that participate in the realm of SRI. For example, the French SWFs and the Ireland Strategic Investment Funds (the former National Pension Reserve Fund) are signatories to the UN PRI. The Canadian Alberta Heritage Savings Trust Fund (AHSTF) and Irish Strategic Investment Funds have signed the Carbon and Water Disclosure Project. The Abu Dhabi Mubadala Development Company (Mubadala) is the member of the Long-Term Investors Club. See Van der Zee, *In Between*, *supra* note 37, at 57–62.

⁹²See Bryan J. Balin, *Sovereign Wealth Funds: A Critical Analysis* (Sept. 23, 2009), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1477725. See also Jerry Harris, *Statist Globalization in China, Russia and the Gulf States*, 8 *PERSP ON GLOBAL DEV. & TECH.* 139 (2009).

⁹³A study demonstrates that SWF investment that includes active involvement of political influence results in worse performance due to less professional decision-making processes or distortions in the investing process. See Bernstein, *supra* note 89, at 38.

⁹⁴See Reinhard Steurer, *The Role of Governments in Corporate Social Responsibility: Characterising Public Policies on CSR in Europe*, 43 *POL'Y SCI.* 49 (2010).

⁹⁵See Van der Zee, *Sovereign Wealth Funds*, *supra* note 34, at 147–48.

countries, will be politically damaged.⁹⁶ On the more positive side, SWFs are usually established to promote a sustainable economy, benefit future generations, and for social or macroeconomic consideration.⁹⁷ To avoid the negative and promote the positive, therefore, it makes sense for SWFs to promote SRI and sustainable development.

Furthermore, SWFs can weather the possible risks of SRI while helping their home countries meet their obligations. With government backing, and due to the huge size of sovereign wealth as compared to other private investors, SWFs can tolerate higher risk⁹⁸ and consider broader risks and externalities in the market. Moreover, although SWFs function like private actors and most of them have separate legal identity, they are often regarded as political instruments or governmental authority.⁹⁹ This character often means their activities can have a significant effect on their home countries' obligations, including such obligations as human rights, environmental protection, and sustainable development. According to Clark and Knight, SWFs can be used by governments as legal instruments to exercise their responsibility to these interests, which contribute to the principle of intergenerational equity as a customary norm in international law.¹⁰⁰ The Australian Future Fund, for instance, operates to support the principle of "ecological sustainable development" because its government, the political sponsor, made a commitment to international best practices for sound governance.¹⁰¹ Therefore, as state-owned investment funds, SWFs can promote SRI to help their home countries avoid being accused of breach of duty.

Furthermore, those SWFs that take ESG or ethical factors into account have been highly recognized by the international community because they not only seek financial returns but also improve their own corporate governance as well as that of target companies by using SRI strategies, especially shareholder activism. Empirical studies show that investments done according to SRI principles do not result in lower returns than conventional investment options.¹⁰² Moreover, Fernandes' study finds that the majority of SWF investments do not completely control target companies, and even when largely invested in target companies, do not harm these companies.¹⁰³ He also finds that those companies in which SWFs invest, outperform and "enjoy higher valuations" due to the oversight by SWFs through their ownership rights.¹⁰⁴ Hence, the responsible investment of SWFs does not undermine financial returns but instead, improves the reputation of their home countries.

Third, adopting SRI or undertaking responsible investment is a way for SWFs to meet their fiduciary duty¹⁰⁵ to their shareholders, i.e., the government of their home countries and to take responsibility for

⁹⁶See Richardson, *Sovereign Wealth Funds*, *supra* note 9, at 127.

⁹⁷See *Santiago Principles*, *supra* note 67.

⁹⁸See Richardson, *Sovereign Wealth Funds*, *supra* note 9, at 127.

⁹⁹See Van der Zee, *Sovereign Wealth Funds*, *supra* note 34, at 147–148.

¹⁰⁰See Gordon L. Clark & Eric R. W. Knight, *Temptation and the virtues of long-term commitment: the governance of sovereign wealth fund investment*, 1 *ASIAN J. INT'L L.* 321 (2011).

¹⁰¹*Id.* at 324.

¹⁰²See RBC Global Asset Management Report, *Does Socially Responsible Investing Hurt Investment Returns?* (Sept. 2012), http://funds.rbcgam.com/_assets-custom/pdf/RBC-GAM-does-SRI-hurt-investment-returns.pdf.

¹⁰³See Nuno Fernandes, *The Impact of Sovereign Wealth Funds on Corporate Value and Performance*, 26 *J. APPLIED CORP. FIN.* 76, 84 (2014).

¹⁰⁴*Id.*

¹⁰⁵Fiduciary duty is defined by the Freshfields report, which was released by United Nations Environment Programme Finance Initiative in 2005. According to the Freshfields report, fiduciary duties are "duties imposed upon a person who exercises some discretionary power in the interests of another person in circumstances that give rise to a relationship of trust and confidence." The most important duties are "the duty to act prudently and the duty to act in accordance with

their stakeholders, i.e., the government, the taxpayer, etc.¹⁰⁶ The term “fiduciary” embraces all trust-like situations,¹⁰⁷ and “fiduciary duty” refers to a relationship in which a person or entity owes a duty of loyalty to another over the management of an asset.¹⁰⁸ Although the beneficiary of SWF investment is not a specific person, SWFs still have fiduciary duties. Richardson describes SWFs as “public fiduciaries,” which is different from the general fiduciary relationship. He argues that “in a strict legal sense no SWF stands in fiduciary relationship to society, in the manner traditionally understood in equity doctrine associated with trusts and other fiduciary law contexts.”¹⁰⁹ But, even if not through the same structure, SWFs invest for the interest of the government, residents, and future generations. Thus, SWFs have fiduciary duties to these beneficiaries of their investments.¹¹⁰ The fiduciary relationship as it concerns SRI actions of SWFs can be understood as SWFs, as public entities, managing a pool of national assets on behalf of their home countries and citizens with the goal of undertaking responsible investments for long-term economic and social benefits.

The influence of SWF investments on the financial market and target companies has been admitted by the international community¹¹¹ and supported by several empirical studies.¹¹² Therefore, SWFs undertaking responsible investment can promote and sustain the development of financial markets as well as influence behaviours of target companies through their status as shareholders. These consequences, in turn, benefit the SWFs and their home country.

4. Existing responsible investment practices and initiatives of SWFs

In this section, we describe a range of measures and initiatives that SWFs (in selected countries) use to practice SRI and influence corporate behaviour.

Many SWFs do not have explicit guidelines or policies for practicing SRI; instead, they only mention the notion of SRI in their annual reports or state it as an investment purpose on their official websites. Because some SWFs do not disclose any information to the public regarding their investments, it is

Footnote continued

the purpose for which investment powers are granted.” See Asset Mgmt. Working Grp., U.N. Env’t. Program Finance Initiative, *A legal framework for the integration of environmental, social and governance issues into institutional investment* (Oct. 2005) (Freshfields Bruckhaus Deringer, international law firm, contributing researcher and reporter), http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf. For more information about fiduciary responsibility, see Asset Mgmt. Working Grp., U.N. Env’t. Program Finance Initiative, *Fiduciary responsibility: legal and practical aspects of integrating environmental, social and governance issues into institutional investment* (July 2009) (follow-up to Freshfields Report), <http://www.unepfi.org/fileadmin/documents/fiduciaryll.pdf>.

¹⁰⁶Even though it still remains unclear to whom SWFs should be accountable, the Santiago Principles mention that the board of directors or managers of SWFs should act in the interest of the SWF, which can be regarded as “an attempt to introduce a sense of fiduciary duty within the SWF” See Ashby Monk, *Recasting the Sovereign Wealth Fund Debate: Trust, Legitimacy, and Governance*, 14 *NEW POL. ECON.* 451, 463 (2009).

¹⁰⁷See L.S. Sealy, *Fiduciary Relationships*, 20 *CAMBRIDGE L. J.* 69 (1962).

¹⁰⁸See Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 *N.Y.U. L. REV.* 1045, 1046 (1991); see also Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 *J. L. & ECON.* 425 (1993).

¹⁰⁹See Richardson, *Sovereign Wealth Funds*, *supra* note 9, at 126.

¹¹⁰See Van der Zee, *In Between*, *supra* note 37, at 35.

¹¹¹See Santiago Principles, *supra* note 68; see OECD Declaration, *supra* note 81.

¹¹²See Hélène Raymond, *The effect of Sovereign Wealth funds’ investments on stock markets*, UNIVERSITÉ PARIS OUEST NANTERRE (Nov. 20, 2008), <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.375.4892&rep=rep1&type=pdf>; see also PricewaterhouseCoopers, *The Impact of Sovereign Wealth Funds on economic success*, (Oct. 2011), <https://www.pwc.co.uk/assets/pdf/the-impact-of-sovereign-wealth-funds-on-economic-success.pdf>.

difficult to ascertain whether or how they consider ESG issues when investing¹¹³ or whether they have already adopted SRI strategies. There are SWFs, though, that are keen to implement SRI strategies to maintain the reputation of their home countries and pursue long-term returns. Such SWFs either adopt SRI strategies or consider ESG factors in their investment strategies and practice their ethical philosophy via various social activities, e.g., signing relevant soft regulations or participating in responsible investment programmes.

SRI activities can be constrained either by legal regulatory mandate or voluntary guidelines and policies. Among these, some mechanisms or strategies may be performed well while others may be criticized for negative effects. Analysing the existing cases for SRI initiatives by certain SWFs can help other SWFs draw lessons and build their own preferential responsible investment policies.

Among the top ten SWFs,¹¹⁴ only the Norwegian Government Pension Fund – Global (GPF) has a specific legal mandate for its SRI practices and is scrutinized by a specialized agency.¹¹⁵ SWFs from Gulf countries (e.g., Abu Dhabi, Saudi Arabia, Kuwait, Qatar) and Asian emerging economies (e.g., China¹¹⁶ and Singapore) do not have specific guidelines, and some only briefly mention sustainable long-term returns in their annual reports or on their websites. Apart from these largest SWFs, there are SWFs that intend to implement or have already implemented SRI strategies when making decisions.

This section below selectively examines examples of SWFs from Norway, New Zealand, France and Australia (these funds are also sovereign pension reserve funds, and because of certain shared similarities, this research treats the selected French fund as a SWF). SWFs in Norway, New Zealand and France have been constrained by legislative mandates,¹¹⁷ while SWFs in Australia have no clear legal mandate for SRI but do have some policy initiatives.

4.1 The Norwegian Government Pension Fund-Global

The Norway's Government Pension Fund – Global (GPF)¹¹⁸ established in 1990, currently is the largest¹¹⁹ SWF in the world using ethical guidelines for its investment decision-making. The GPF has a set of ethical guidelines¹²⁰ based on two elements: to ensure reasonable profits for future generations¹²¹ and to

¹¹³See Hugues Létourneau, *The Responsible Investment Practices of the World's Largest Government Sponsored Investment Funds* 8 (2013) (M.A. Thesis, Carleton University).

¹¹⁴See Sovereign Wealth Fund Inst., *Sovereign Wealth Fund Rankings: Largest Sovereign Wealth Funds by Assets Under Management* (updated Apr. 2017), <http://www.swfinstitute.org/sovereign-wealth-fund-rankings>.

¹¹⁵See Richardson & Lee, *supra* note 49, at 389.

¹¹⁶The National Social Security Fund of China, as one of the largest SWFs worldwide and largest pension fund in China, considers "responsible investment" in its investment principles. See Park & Kowal, *supra* note 66.

¹¹⁷See Benjamin J. Richardson, *To govern and be governed: The governance dimensions of SRI's influence, in SRI IN THE 21ST CENTURY: DOES IT MAKE A DIFFERENCE TO SOCIETY?* 255 (Critical Studies on Corporate Responsibility, Governance and Sustainability, vol. 7) (Céline Louche & Tessa Hebb eds., 2014).

¹¹⁸GPF was previously named the Petroleum Fund. The GPF and the Government Pension Fund – Norway are uniformly called the Government Pension Fund according to the Pension Fund Act in 2006. See *Santiago Principles*, *supra* note 67.

¹¹⁹As of November 2016, Norway's SWF was the largest SWF, with 885 billion dollars-worth of assets under its management. See Statista, *Largest sovereign wealth funds worldwide as of June 2017, by assets under management*, <http://www.statista.com/statistics/276617/sovereign-wealth-funds-worldwide-based-on-assets-under-management> (last visited May 11, 2017).

¹²⁰To undertake its ethical guideline, GPF adopted the following strategies: "(i) achieve high returns subject to moderate risk; (ii) exercise the ownership rights associated with the equity holdings (done by Norges Bank); and (iii) exclude some companies from the investment universe (decided by the Ministry based on advice from Council on Ethics)." See *Santiago Principles*, *supra* note 67.

¹²¹*Id.*

avoid investments that contribute to unethical activities and constitute unacceptable risks.¹²² The governance structure of the GPFG is clearly organized. The Ministry of Finance is the owner of the GPFG and responsible for management, and has delegated to the Norges Bank Investment Management (NBIM) the operational management of the GPFG and the exercise of GPFG ownership rights. The duty of the NBIM is to safeguard the long-term financial returns. In order to ensure a legitimate and reasonable GPFG portfolio, a Council on Ethics¹²³ was established, with the aim of excluding companies from its investment list whose businesses are contributing, or will contribute, to grossly unethical acts. The Council on Ethics¹²⁴ is responsible for submitting recommendations to the Executive Board of Norges Bank, which makes the final decisions for exclusion. For the product-based coal criterion, Norges Bank makes exclusion decisions based on recommendations from NBIM.¹²⁵

Based on the idea that companies who respect ethical norms and principles will be beneficial to the GPFG and meet its long-term objectives, the GPFG is required to consider SRI in its operations. Thus, ethical guidelines¹²⁶ help implement responsible investment, with a view that sustainable development will benefit both the economy and society. The responsibility of the GPFG to achieve maximum profits and returns in line with sustainable development principles is laid down in these ethical guidelines, along with mechanisms to attain the given goals. One study has also argued that the ethical guidelines and SRI actions of the GPFG show that Norway is using its GPFG as a way to influence the development of transnational rules of law.¹²⁷ More specifically, because the ethical guidelines comprehend both national regulation in Norway and international regulations, the GPFG can use its shareholder power to influence CSR, determine corporate governance, and help Norway engage in international law-making processes via the financial market. SRI strategies, especially shareholder activism, are used by the GPFG to spread the notion of Norwegian government and society.

Even though the ethical guidelines have gained broad political support from Norway's authorities, it cannot be regarded as merely political motivation¹²⁸ or a foreign policy instrument.¹²⁹ On the contrary, the

¹²²See Anita M. Halvorsen, *Using the Norwegian Sovereign Wealth Fund's Ethical Guidelines: A Model for Investors*, 8 Eur. Co. L. 88 (2011).

¹²³The role of the Council on Ethics (Etikkradet) is to assess whether the investment activities of GPFG are consistent with the Ethical Guidelines. For more information, see *Council on Ethics for the Norwegian Government Pension Fund Global*, <http://etikkradet.no/en/council-on-ethics/>.

¹²⁴The Ministry of Finance issues revised guidelines about exclusion and observation policies for GPFG and appoints five new members to the Council on Ethics. See *Council on Ethics for the Government Pension Fund Global, Annual Report 2014*, <http://etikkradet.no/files/2017/02/Council-on-Ethics-2014-Annual-Report-1.pdf>.

¹²⁵See Norges Bank Inv. Mgmt., *Observation and Exclusion of Companies* (as of April 14, 2016 update), [hereinafter *NBIM Observation*], <http://www.nbim.no/en/responsibility/exclusion-of-companies>; see also Press Release, Norges Bank Inv. Mgmt., First coal exclusions from the government pension fund global (Apr. 14, 2016), <http://www.nbim.no/en/transparency/news-list/2016/first-coal-exclusions-from-the-government-pension-fund-global>.

¹²⁶The current ethical guidelines were adopted by the Ministry of Finance on March 1, 2000. In 2000, the Ministry of Finance also issued two Guidelines: the Guidelines for Observation and Exclusion from the Government Pension Fund Global's Investment Universe (Guideline I) and the Guidelines for Norges Bank's Work on Responsible Management and Active Ownership (Guideline II). These guidelines apply to the exclusion and observation of companies that are involved in unethical activities, as well as supporting the use of shareholder activism to exert influence on target companies. See BENJAMIN J. RICHARDSON, *FIDUCIARY LAW AND RESPONSIBLE INVESTING: IN NATURE'S TRUST* 242 (2013).

¹²⁷See Larry Catá Backer, *Sovereign Investing and Markets-Based Transnational Rule of Law Building: The Norwegian Sovereign Wealth Fund in Global Markets*, 29 AM. U. INT'L L. REV. 1 (2013).

¹²⁸See Halvorsen, *supra* note 122, at 89.

¹²⁹The investment strategy of GPFG is based on financial market practices with moderate risk and a long-term horizon. Even though the Ministry of Finance supports the operation of GPFG, it is not regarded as a strategic or political vehicle.

objective to maintain sound financial returns with consideration of sustainable development is based on internationally recognized standards and principles.¹³⁰

For SRI strategies, the GPFG focuses on using negative screening to exclude companies from its investment list or put companies under observation. Seldom does it adopt positive screening or positive selection, as that approach may narrow its investment universe.¹³¹ In 2008, the GPFG evaluated its ethical guidelines and implemented SRI strategies that included an assessment of positive screening.¹³² But it found that positive screening would tend to result in reduction of target companies and increase an “unsystematic risk.”¹³³

The GPFG negative screening therefore excludes companies from its portfolio to meet its ethical obligations.¹³⁴ For example, based on its ethical guidelines, the GPFG excludes companies that violate certain social benefits¹³⁵ or fundamental humanitarian principles¹³⁶ or lead to severe environmental damage. It also excludes companies that produce coal or coal-based energy,¹³⁷ antipersonnel landmines,¹³⁸ cluster munitions, nuclear weapons, and tobacco. In order to improve the effectiveness of the exclusion measures, a new tool was introduced: a company is placed “under observation” if there is any doubt as to “whether the conditions for exclusion have been fulfilled or how the company’s behaviour

Footnote continued

See Minister of Finance Siv Jensen, *The Management of the Norwegian Petroleum Wealth – avoiding the resource curse* (Apr. 15, 2015), <https://www.regjeringen.no/en/aktuelt/the-management-of-the-norwegian-petroleum-wealth/id2406271>; see also Consultation paper - Evaluation of the Ethical Guidelines for the Government Pension Fund-Global (n.d.), https://www.regjeringen.no/globalassets/upload/FIN/Vedlegg/aff/evaluation_ethical_Guidelines.pdf.

¹³⁰Such standards include the UN Global Compact, the OECD Guidelines for Multinational Enterprises, and the OECD Guidelines for Corporate Governance, as well as principles laid down by the International Labour Organization (ILO).

¹³¹Many studies show that “SRI funds that narrow their investment universe with many positive and complex restrictions tend to underperform relative to funds that operate on the basis of simpler negative principles.” See Thore Johnsen & Ole Gjølberg, *Ethical Management of the Government Pension Fund – Global: An Updated Analysis*, 4 (May 14, 2008), https://www.regjeringen.no/globalassets/upload/fin/statens-pensjonsfond/ethical_management_of_the_government_pension_fund-global.pdf.

¹³²According to the definition of positive screening by the GPFG, positive screening or selection is an approach which selects the most ethical companies or invests in industries or companies that are aligned with responsible investment views of the investor. See Consultation Paper, *supra* note 129.

¹³³Johnsen and Gjølberg summarized their analysis that “the more active and extensive positive screening reduces the selection in such a way that one is left with a strong bias towards e.g. large-cap companies. In other words, the screening also implies that one gets a compositional bias, and thereby higher unsystematic risk.” See Johnsen & Gjølberg, *supra* note 131.

¹³⁴See Consultation Paper, *supra* note 129.

¹³⁵One example is gross corruption. The ZTE Corporation, a Chinese telecommunications equipment and systems company, was excluded by the Norges Bank on January 7, 2016.

¹³⁶Examples include serious violations of human rights and serious violations of individuals’ rights in situations of war or conflict. For the former reason, Zuari Argo Chemicals Ltd. (October 14, 2013), Wal-Mart Stores Inc. (May 31, 2006), and Wal-Mart de Mexico SA de CV (May 31, 2006) were excluded by the Norges Bank. For the latter reason, Africa Israel Investments (January 30, 2014), Danya Cebus (January 30, 2014) and Shikun & Binui Ltd. (May 31, 2012) were excluded. See NBIM Observation, *supra* note 125.

¹³⁷By April 14, 2016, 52 companies were excluded because they produced coal or coal-based energy. Among these companies, 22 companies were from the United States. See NBIM Observation, *supra* note 125.

¹³⁸Singapore Technologies Engineering was excluded in 2002, while Norges Bank made a decision to revoke the exclusion on the basis of a recommendation from the Council on Ethics in 2016. See Norges Bank Inv. Mgmt., *Decision to revoke exclusion of company from the government pension fund global* (Sept. 30, 2016), <https://www.nbim.no/en/transparency/news-list/2016/decision-to-revoke-exclusion-of-company-from-the-government-pension-fund-global>.

will develop in the future.¹³⁹ Before making an exclusion decision, the Council on Ethics routinely assesses companies on the basis of national and international regulations. If there is evidence that a company violates international principles or soft law, or even breaches national law, the Council on Ethics will report and make recommendations for the Norges Bank,¹⁴⁰ which may put the company under observation or exclude the company from the investment list. Its exclusion and observation criteria include product-based exclusion of companies and conduct-based exclusion of companies.¹⁴¹ In practice, as of April 2016, 118 companies had been excluded from the investment universe of the GPF, ¹⁴² and 2 companies were placed under observation.¹⁴³

The GPF tries to influence the management of target companies and force these companies to enhance their financial or social performance via shareholder activism, i.e., active management or divestment. The GPF actively and directly engages in the operation of the target company by exercising voting and other shareholder rights to address ESG issues. In terms of active engagement, the NBIM, as the operational manager of the GPF, uses various approaches to build knowledge about the factors that may be significant for companies' long-term profits, or meets with the representatives of companies in which it invests for discussion.¹⁴⁴ Moreover, the NBIM also influences the target companies via shareholder proposals, resolutions, and voting in the annual meeting. In order to improve and ensure the long-term active ownership work, the NBIM set up a Corporate Governance Advisory Board (CGAB) in 2013.¹⁴⁵ The Norges Bank support proxy access right when shareholders cannot exert the rights effectively concerning US companies.¹⁴⁶

¹³⁹See Norwegian Ministry of Finance, *Government Pension Fund Global: responsible investment*, 31 (2010), https://www.regjeringen.no/globalassets/upload/FIN/brosjyre/2010/spu/english_2010/SPU_hefte_eng_ebook.pdf.

¹⁴⁰Before January 1, 2015, exclusion decisions were made by the Ministry of Finance.

¹⁴¹The requirements are as follows:

The Fund shall not be invested in companies which themselves or through entities they control:

- a) produce weapons that violate fundamental humanitarian principles through their normal use
- b) produce tobacco
- c) sell weapons or military materiel to states that are subject to investment restrictions on government bonds as described in the management mandate for the Fund section 3-1(2)(c).

Companies may be put under observation or be excluded if there is an unacceptable risk that the company contributes to or is responsible for:

- a) serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour and the worst forms of child labour
- b) serious violations of the rights of individuals in situations of war or conflict
- c) severe environmental damage
- d) gross corruption
- e) other particularly serious violations of fundamental ethical norms.

See Norwegian Ministry of Finance, *Guidelines for observation and exclusion from the Government Pension Fund Global, Government* (last updated Apr. 14, 2015), https://www.regjeringen.no/globalassets/upload/fin/statens-pensjonsfond/guidelines-for-observation-and-exclusion-14-april-2015_new.pdf.

¹⁴²For more information about the excluded companies, see NBIM *Observation*, *supra* note 125.

¹⁴³Petroleo Brasileiro SA was placed under observation due to the risk of severe corruption, while Astra International Tbk PT was placed under observation due to the risks of severe environmental damage. See NBIM *Observation*, *supra* note 125.

¹⁴⁴See NBIM, *Consultation – Responsible Investment Strategy for the Government Pension Fund Global* (Jan. 29, 2014), <http://www.nbim.no/en/transparency/submissions-to-ministry/2014/consultation-responsible-investment-strategy-for-the-government-pension-fund-global>.

¹⁴⁵See NBIM, 2014 *Responsible Investment Government Pension Fund Global* (Feb. 5, 2015), <http://www.nbim.no/globalassets/reports/2014/2014-responsible-investment.pdf>.

¹⁴⁶The NBIM stated that it will encourage the boards of U.S. companies to propose proxy access. See NBIM, *Proxy Access At US Companies* (Position Paper, Mar. 13, 2015), <http://www.nbim.no/en/responsibility/our-voting-records/position-papers/proxy-access-at-us-companies>.

If active engagement does not positively affect the company or the company refuses to change its unethical conduct, the GPFG might opt to divest.¹⁴⁷ Based on considerations of ESG factors, the GPFG announced its divestment from 49 companies in 2014. During the past three years, the GPFG has divested from a total of 114 companies that are responsible for unethical acts or lack a sustainable business model.¹⁴⁸

4.2 The New Zealand Superannuation Fund

The New Zealand Superannuation Fund (NZSF) was established in 2001 pursuant to the New Zealand Superannuation and Retirement Income Act (the Act), with an aim to alleviate the future burden of pension debt.¹⁴⁹ Although the NZSF was funded by capital contributions from the New Zealand government, it has been managed by a separate Crown entity called the Guardians of New Zealand Superannuation (Guardians).¹⁵⁰ Under the Act,¹⁵¹ the Guardians have discretion to manage and invest the NZSF to maximize return with moderate risk, on a commercial, prudential basis, and so as to avoid “prejudice to New Zealand’s reputation as a responsible member of the world community.”¹⁵² The Act also has a responsible investment policy that briefly outlines the main responsible investment standards and mechanisms for the NZSF that is supervised by the Guardians. The responsible investment policy and the Act¹⁵³ require the NZSF to be invested ethically, and the Guardians are responsible for ensuring that NZSF investment is committed to responsible investment, embeds ESG considerations, and demonstrates favourable investment practices.¹⁵⁴

The responsible investment framework of NZSF embraces universally recognized standards (e.g., Corporate Governance Guidelines, Proxy Agency voting guidelines, and the UN Global Compact) and guidelines published by the New Zealand Financial Market Authority. Due to lack of expertise in professional areas, the Guardians do not solely undertake the task of ensuring responsible investment policies. They rely on external agencies¹⁵⁵ to ensure that the NZSF’s portfolio comports with responsible investment policy approaches.

Like GPFG, the NZSF uses negative screening to exclude companies that are directly involved in manufacture of unethical products¹⁵⁶ or severe breaches of responsible investment standards. The

¹⁴⁷See Van der Zee, *In Between*, *supra* note 37, at 20.

¹⁴⁸See NBIM, *Work on Responsible Investment Strengthened* (Feb. 5, 2015), <http://www.nbim.no/en/transparency/news-list/2015/work-on-responsible-investment-strengthened>.

¹⁴⁹See *Santiago Principles*, *supra* note 67.

¹⁵⁰For more information about the governance of NZSF, see NZSUPERFUND, *Governance*, <https://www.nzsuperfund.co.nz/nz-super-fund-explained/governance> (last visited May 1 2016).

¹⁵¹According to the Act, the Guardians are “not a trustee.” See Benjamin J. Richardson, *Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand*, 2 *NORDIC J. COM. L.* 1, 17 (2011) [hereinafter, *Quest*].

¹⁵²New Zealand Superannuation and Retirement Income Act 2001, § 58(2)(c).

¹⁵³These regulations are “less prescriptive” than Norway’s ethical regulations. See Richardson, *Quest*, *supra* note 151, at 18.

¹⁵⁴See Guardians of New Zealand Superannuation, *Responsible Investment Framework*, https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/2016-Responsible_Investment_Framework.pdf (last visited May 12 2016).

¹⁵⁵Examples of such agencies are Institutional Shareholder Services and InnoVest Strategic Value Advisor. See Richardson, *Quest*, *supra* note 151, at 252.

¹⁵⁶According to the current exclusion policy of the NZSF:

Companies who are directly involved in the following activities will be excluded from the portfolio:

1. the manufacture of cluster munitions
2. the manufacture or testing of nuclear explosive devices (NEDs)

Guardians of the NZSF make exclusion decisions based on international conventions, New Zealand law, Crown actions,¹⁵⁷ and principles in their Responsible Investment Framework,¹⁵⁸ as well as the target companies' activities. Because the goal of NZSF's responsible investment is to improve the behaviour of companies, exclusion is the last method used to implement responsible investment. As of December 2015, 169 companies had been excluded from the NZSF's investments, most of which are involved in the manufacture of tobacco.¹⁵⁹

In terms of shareholder activism, the Guardians had a deep level of active engagement with 133 companies out of the 6151 companies in its portfolio.¹⁶⁰ From 2014 to 2015, the NZSF participated in collaborative engagements with 119 companies and direct engagements with 14 companies.¹⁶¹ Both the GPF and the NZSF are actively engaged through their portfolios with climate change. The NZSF has divested its shareholdings from companies involved in the manufacture of tobacco and cluster munitions. During 2015, the Guardians of the NZSF were requested or lobbied by individuals and activist groups to divest from Israeli companies¹⁶² and companies who operate in the Occupied Palestinian Territories.¹⁶³

According to the responsible investment policies and guidelines of both the GPF and the NZSF, they prefer to use shareholder activism in target companies, active engagement in particular, to promote responsible investment and positively influence the behaviour of companies. They may also use exclusion for certain circumstances and specific sectors.

4.3 The French Pension Reserve Fund

In addition to the GPF and NZSF, the French Pension Reserve Fund (Fonds de Réserve pour les Retraites —FRR) also has a legal mandate to practice SRI. The FRR was established by the Social Security Financing Act 1999¹⁶⁴ and it was separated from the French Old Age Solidarity Fund by Law N°2001-624 in July 2001. The FRR, although owned and funded by the government, is governed by a Supervisory Board and Executive Board.

The FRR declares itself to be a long-term investor that promotes sustainable finance. It aims to optimize long-term investment returns and to promote "balanced economic, social and environmental

Footnote continued

3. the manufacture of anti-personnel mines
4. the manufacture of tobacco
5. the processing of whale meat.

See NZSUPERFUND, *Exclusions* [hereinafter NZSUPERFUND, *Exclusions*], <https://www.nzsuperfund.co.nz/how-we-invest-responsible-investment/exclusions> (last visited May 1 2016).

¹⁵⁷*Id.*

¹⁵⁸See *Guardians of New Zealand Superannuation, Responsible Investment Framework*, *supra* note 154.

¹⁵⁹See NZSUPERFUND, *Exclusions*, *supra* note 156.

¹⁶⁰See NZSUPERFUND, *Annual Report 2015*, <https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/NZ%20Super%20Fund%202014-15%20Annual%20Report.pdf>.

¹⁶¹*Id.*

¹⁶²For example, the Aotearoa Boycott, Divestment and Sanctions movement (BDS), Justice for Palestine, Justice for Palestinian Matters, the Palestine Solidarity Network, People Against Israel Apartheid, and the Wellington Palestine Group. See NZSUPERFUND, *Annual Report 2015*, *supra* note 160.

¹⁶³*Id.*

¹⁶⁴See Wilmington Publishing & Information, *Pension Funds Online: France*, <http://www.pensionfundsonline.co.uk/content/country-profiles/france/117> (last visited May 1 2016).

development.¹⁶⁵ The FRR contributes to the retirement plan in accordance with SRI principles, and it also promotes CSR in target companies.¹⁶⁶ Compared to the previously-discussed SWFs, especially the GPGF, the FRR lacks a detailed legal mandate for ethical investment, and its SRI guidelines are quite simple. Most of its SRI measures are developed by administrative policy or interpreted by the Supervisory Board, not constrained by specific investment regulations. Its SRI principles are simply based on the U.N. Global Compact, while its investment decision-making is mainly based on the U.N. Principles of Responsible Investment (UNPRI) as far as the social and environmental performance of target companies are concerned.¹⁶⁷ To back up its SRI actions, the FRR has developed five SRI principles followed by specified areas of concern (including human rights, job development, environment, consumer rights and corporate governance).¹⁶⁸

Although the FRR is required to disclose its consideration of ESG factors during decision-making, it is not explicitly required to practice SRI. But its SRI initiatives demonstrate that even though the FRR lacks a legal mandate, SRI progress can be made via policy-making. To demonstrate its SRI initiatives, the FRR joined the Carbon Disclosure Project for the first time in late 2005. It signed the UNPRI in 2006 to promote responsible investment and to honour its commitments to the principles. In 2008, the Supervisory Board adopted a socially responsible investment strategy. In 2014, it signed a statement on climate change.¹⁶⁹ In order to practice SRI, the Responsible Investment Committee of the Supervisory Board was created. In 2013, the FRR Supervisory Board adopted a new five-year SRI strategy (2013–2017) that extends the FRR's base for SRI action beyond the traditional scope to emerging markets and provides new opportunities to exploit small and medium capitalization equities.¹⁷⁰ Similar to the GPGF and NZSF, the FRR is focused on the issue of climate change.¹⁷¹ Since its establishment, the challenges of climate change have become part of their investment strategy.

As for selecting target companies, the FRR uses both negative screening and positive screening (it prefers the “best-in-class” approach) methods. For negative screening, as of 31 March 2016, after adding two new companies to its exclusion list,¹⁷² there were 20 companies on the FRR exclusion list. Temasek Holdings, a famous SWF in Singapore, which was on the exclusion list, has been removed from

¹⁶⁵See Fonds de Reserve pour les Retraites, *The FRR's Missions*, <http://www.fondsdereserve.fr/en/missions> (last visited May 12, 2017).

¹⁶⁶See Reinhard Steurer, *CSR and Governments: Public Policies on CSR in Europe*, in *CORPORATE SOCIAL RESPONSIBILITY* 253 (Esben Rahbek & Gjerdrum Pedersen eds., 2015).

¹⁶⁷See Fonds de Reserve pour les Retraites, *Socially Responsible Investment: SRI Principles of the FRR*, <http://www.fondsdereserve.fr/en/socially-responsible-investment/principles> (last visited May 1, 2016).

¹⁶⁸The five SRI principles include: “respect basic human and worker rights; develop job development through improving the quality of human resource management; assume responsibility for the environment; respect the consumer and fair trade practices; promote good corporate governance.” See Fonds de Reserve pour les Retraites, *Socially responsible investment principles applicable to FRR awarded mandates for this approach to asset management* (n.d.), http://www.fondsdereserve.fr/documents/05_5_SRI_principles_FRR.pdf (last visited May 11, 2017).

¹⁶⁹See 2014 *Global Investor Statement on Climate Change*, http://www.fondsdereserve.fr/documents/Global_Investor_Statement_on_Climate_Change.pdf (last visited May 12 2017).

¹⁷⁰See Fonds de Reserve pour les Retraites, *Responsible investment strategy 2013–2017*, <http://www.fondsdereserve.fr/documents/SRI-Strategy-2013-2017.pdf> (last visited May 1 2016).

¹⁷¹The FRR has signed various international commitments to promote environmental protection. See Fonds de Reserve pour les Retraites, *The FRR and Climate Change*, <http://www.fondsdereserve.fr/en/socially-responsible-investment/the-fr-and-climate-change> (last visited May 1 2016).

¹⁷²China Poly Group Corporation and S & T Dynamics. See Fonds de Reserve pour les Retraites, *Exclusions List*, <http://www.fondsdereserve.fr/en/socially-responsible-investment/exclusions-list> (last visited May 12, 2017).

this list, but detailed information about this cannot be found on FRR's website. Its selection of portfolio by the "best in class" approach is guided by its own SRI principles and the U.N. Global Compact, as well as basic standards recognized by the International Labour Organization and other international organizations.¹⁷³ The FRR also incorporates ESG criteria into investment decisions and portfolio management. It believes that the ESG factors can help its managers fully understand the risks and opportunities of target companies, which can also impact corporate value and the returns of the fund.

In terms of corporate engagement, the FRR utilises an active policy of voting proxies at annual shareholder meetings and communicating with specific target companies. In 2005, the FRR published a set of proxy voting guidelines as mandates for its asset managers.¹⁷⁴ Under the mandates, asset managers are obligated to vote proxies and conduct independent analyses of draft resolutions.¹⁷⁵ This active approach aims to improve corporate governance of target companies through active participation, long-term investment, and efforts to raise the standards of corporate governance.¹⁷⁶ As of December 2015, the FRR had participated in 3073 annual meetings¹⁷⁷ and had voted on 2131 stocks in its equity portfolio. The resolution approval rate in its portfolio was 84.3%.¹⁷⁸

Compared to the SRI initiatives of GPF and NZSF, the FRR's measures have two distinguishing features. The first one is the "social economy" approach, which emphasizes equality and democracy in economic and social development. The other is to promote transparency and report extra-financial criteria not only for itself but also for relevant companies.¹⁷⁹ For example, in 2006, based on extra-financial criteria, the FRR put forward a process to assess its entire portfolio.

4.4 Australia's Future Fund

The Future Fund was established under the Future Fund Act 2006 (the Act)¹⁸⁰ for the benefit of future generations and the long-term financial position of the Australian government. The Future Fund is controlled by the Future Fund Board of Guardians (the Board), which, with the support of the Future Fund Management Agency (the Agency), is responsible for the fund's investment and performance.¹⁸¹

¹⁷³See Reinhard Steurer et al., *Socially Responsible Investment in EU Member States: Overview of government initiatives and SRI experts' expectations towards governments* 31 (Final Report to the EU High-Level Group on CSR, European Commission, Apr. 2008), http://www.sustainability.eu/pdf/csr/policies/Socially%20Responsible%20Investment%20in%20EU%20Member%20States_Final%20Report.pdf.

¹⁷⁴The FRR Supervisory Board formally ratified these guidelines, acting on the recommendation of the Executive Board.

¹⁷⁵See Fonds de Reserve pour les Retraites, *Proxy Voting Guidelines* (Feb. 2011), http://www.fondsdereserve.fr/documents/Proxy_voting_guidelines_February_2011.pdf.

¹⁷⁶*Id.*

¹⁷⁷As for annual general meetings, 20.7% in Asia-Pacific zone, 32.3% in Europe without France, and 36.2% in North America. See Fonds de Reserve pour les Retraites, *Voting Proxies*, <http://www.fondsdereserve.fr/en/voting-proxies> (last visited May 12, 2017).

¹⁷⁸*Id.*

¹⁷⁹The FRR encourage companies in the extractive industries sector to support the Extractive Industries Transparency Initiative (EITI). The aim of EITI is to strengthen transparency and responsibility in this sector. The FRR is "co-leader" of a collaborative engagement initiative on the management of extra-financial risks associated with the supply chain in the textile sector. See Fonds de Reserve pour les Retraites, *Initiatives Supported by the FRR*, <http://www.fondsdereserve.fr/en/socially-responsible-investment/supported-initiatives> (last visited May 12, 2017).

¹⁸⁰See Federal Register of Legislation, Future Fund Act 2006, <https://www.legislation.gov.au/Details/C2016C00338> (last visited May 12, 2016).

¹⁸¹The Board and Agency also invest the assets of other funds: the Nation-building Funds, the Disability Care Australia Fund, and the Medical Research Future Fund. See futurefund, *Our funds*, <http://www.futurefund.gov.au/about-us/our-funds> (last visited May 12, 2017).

The Board operates independently from the government but is required to report the fund's performance annually to Parliament.¹⁸² The Agency acts as the operational and administrative manager of the fund, which recommends appropriate investment strategies for the fund as well as the implementation of the strategies to the Board.¹⁸³ Compared with some of the above-mentioned SWFs, although the Future Fund has long-term financial objectives, the government has not provided an explicit legislative mandate to practice SRI.

However, there has been some legislative attempt to impose an SRI mandate. According to the Act, the responsible Ministers give the Board written directions with regard to "maximising the return earned on the Fund over the long term, consistent with international best practice for institutional investment."¹⁸⁴ The government also issued directions that recommend that the Board consider ESG issues. The Board has recognized the inter-relationship between ESG issues, reputational risks, and financial return maximisation, and it therefore includes the policy of ownership rights and ESG risk management in its statement of investment policies. This statement is designed to promote SRI action by the Future Fund and increase the awareness of the importance of ESG considerations in investment decision-making and the positive relationship between sound governance and investment value.¹⁸⁵ It also demonstrates that social externalities and ethical risks can permeate the investment policies of SWFs.¹⁸⁶

As of October 2012, the Future Fund became a signatory to the UNPRI pursuant to the inquiry of the Parliament. Although there is no legally binding regulation for implementation of SRI regulations by the Board,¹⁸⁷ the above-mentioned, binding Ministerial directives can support the Future Fund in engaging in some SRI activities to avoid risking the reputation of the Australian government. The Australian government believes that there are adequate mechanisms to ensure responsible investment by the Future Fund.

As for SRI strategies, the Future Fund generally utilises active engagement, not exclusion, to influence target companies and ensure financial value. The Board believes ESG factors enable investors and target companies to better understand risks and opportunities. The Board also recognizes that ESG factors will support financial returns maximization and have a potential impact on the performance of its portfolio. Managing these factors well will contribute to a sustainable system. Therefore, the Board and its managers use active engagement with target companies to improve the understanding of ESG issues.

The Future Fund uses the exercise of ownership rights to influence the corporate governance of target companies and to ensure corporate action in line with long-term shareholder value.¹⁸⁸ The Board provides

¹⁸²See futurefund, *Legislation & governance*, <http://www.futurefund.gov.au/about-us/legislation-and-governance> (last visited May 11, 2017).

¹⁸³See futurefund, *Management Team*, <http://www.futurefund.gov.au/about-us/who-we-are/management-team> (last visited May 11, 2017).

¹⁸⁴See Future Fund Act 2006, *supra* note 181, § 18(1)(1A)(2)(a).

¹⁸⁵See Future Fund Board of Guardians, *Statement of Investment Policies* 30 (Mar. 2017), file:///C:/Users/Owner/Downloads/Statement%20of%20Investment%20Policies%20-%20March%202017.pdf (last visited May 12, 2017).

¹⁸⁶See Richardson & Lee, *supra* note 49, at 408.

¹⁸⁷In 2011 the Green Party tabled an Amendment Bill in the Commonwealth Parliament intended to amend the Future Fund Act. This Bill would have required the responsible Ministers to issue a legal mandate for the Future Fund to practice SRI. However, this legislative attempt was foiled because it was suggested that the Bill would create conflicts of interest, introduce risks and instability, and negatively impact financial returns. See Government Investment Funds Amendment (Ethical Investments) Bill 2011, <http://www.austlii.edu.au/au/legis/cth/bill/gifaib2011624/> (last visited May 1, 2016).

¹⁸⁸See FFBG, *Statement of Investment Policies*, *supra* note 186, at 31.

high-standard principles to guide voting on shareholder solutions, and the Agency, via its external managers, clarifies how to resolve issues with companies. The exercise of ownership rights usually is either via its external managers or directly, as appropriate. Engagement in the global listed equities portfolio is handled by the Board's external investment managers, as managers have more professional financial and corporate knowledge to manage general financial risks or ESG risks.¹⁸⁹ In the 2015–2016 Annual Report, the Fund voted on 1135 resolutions in publicly-listed Australian companies and voted on 37,294 resolutions in publicly-listed overseas companies.¹⁹⁰

In sum, because of the SRI actions and initiatives of above-mentioned SWFs, it can be argued that SWFs can practice SRI or promote CSR via different mechanisms, with or without an explicit legal mandate. In order to influence corporate governance and promote their own sustainable concerns and guarantee financial returns in investee entities, they prefer active engagement to exercise ownership rights or propose shareholder resolutions. The active engagement and other SRI strategies (i.e. negative screening, positive screening, and divestment) are constrained by explicit policy guidelines or legislative regulations. Moreover, it should be highlighted that the SWFs analysed here are highly transparent: they disclose and publish their investment policies, guidelines, activities, and SRI-related information in their annual report or on their official websites. These SWFs, especially the GPFG, NZSF, and Australia Future Fund have the highest scores in the Linaburg-Maduell transparency index.¹⁹¹ Furthermore, the SRI initiatives and measures implemented by these SWFs demonstrate that SWFs' managers or owners have recognised the relevance of ESG factors and social issues for financial returns and long-term profile. Although their activities and policies get political support,¹⁹² the investment decisions of operational internal and external managers are mainly based on financial return maximisation while considering general market externalities and ESG risks. This information is explicitly stated on their websites and in their reports.

5. Legal concerns of socially responsible investment by SWFs

There is consensus that adopting SRI is a trend in the international community, especially among institutional investors. It is beneficial to SWFs' reputations as well as long-term social and financial performances. The examples of the above-mentioned SWFs' SRI measures can be imitated by other SWFs to a certain extent. However, it is critical to be mindful that before implementing SRI strategies, legal questions or issues should be posed or analysed in advance. Such issues include whether their SRI activities have legal support and whether adopting SRI strategies may lead to violation of legal obligations or breach of certain regulations.

¹⁸⁹*Id.*

¹⁹⁰See futurefund, *Annual Report 2015/2016*, <https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKewi17S4rPDTAhUaOsAKHdH1BkMQFggmMAE&url=http%3A%2F%2Fwww.futurefund.gov.au%2F.%2Fmedia%2FFiles%2FFutureFund%2Fo8--Annual-Reports%2FFuture-Fund-Annual-Report-2015-16.pdf%3Fla%3Den&usg=AFQjCNFHbgrGD0P4vfHzV8plZhYtdslybQ&sig2=zb2Tyw49oZ607hPRuvOYRQ>.

¹⁹¹The FRR is not in this index and is not included by the SWF Institute. But the French Strategic Investment Fund (SIF) has a higher score in this index. See Sovereign Wealth Fund Institute, Linaburg-Maduell Transparency Index (1st Quarter 2017), <http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index>.

¹⁹²A study has found that changes in SWF investment strategies and asset allocations are influenced by political motives. See I.J. Alexander Dyck & Adair Morse, *Sovereign Wealth Fund Portfolios*, MFI Working Paper Series No. 2011-003; Chicago Booth Research Paper No. 11-15; Rotman School of Management Working Paper No. 1792850 (Feb. 1, 2011), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1792850.

5.1 *Unlawful intervention*

The first question concerns whether exclusion and divestment implemented by SWFs could be regarded as unlawful intervention. To analyse this question, it is important to answer two questions in advance. Does the acts of a SWF represent the acts of its home country? Also, what is the threshold for unlawful intervention?

For the first question, according to Article 4 of the Responsibility of States for Internationally Wrongful Acts, developed by the International Law Commission, “the conduct of any State organ shall be considered an act of that State.”¹⁹³ Even though SWFs are owned or managed by the government or a public authority, they act commercially and invest for profit maximization without future liabilities. Although the responsible investment of the GPFG and the NZSF may reflect the foreign policies or political policies of their home countries, it does not mean that these SWFs are organs of the State. Hence, the investment behaviours of SWFs cannot be regarded as an organ of the State executing administrative power.

Further, according to Article 5 of the Commission’s work, if an entity that is not an organ of the State still exercises aspects of governmental authority, it shall be considered an act of the State under international law.¹⁹⁴ Since SWFs do not exercise elements of the government of their home countries, their commercial investing acts cannot be considered acts of a State.

Even if a SWF exercises elements of government or its acts are considered acts of the State, their exclusion and divestment activities do not result in unlawful intervention. According to Resolution 2625 adopted by the U.N. General Assembly,¹⁹⁵ unlawful intervention generally includes armed intervention; utilising other types of interference to threaten another State; using economic political measures to coerce another State; and organising or assisting terrorist or armed activities to violate or interfere in the regime of another State. SWFs are not used for exercising the sovereign rights of their home countries to undermine the political, economic and cultural elements of host countries, so the exclusion and divestment measures implemented by SWFs are legal.¹⁹⁶

5.2 *Violations of fairness and justice*

The second question concerns whether SWF actions can result in violating the principles of fairness and justice. These concerns arise in particular with regard to SWF exclusion and divestment strategies. These strategies can be politically motivated; when SWFs exclude certain target companies, they do so to avoid participating in unethical activities and prevent damage to the reputation of home countries, but they do not do it to change or improve the behaviours of target companies. Since the home countries of SWFs

¹⁹³Responsibility of States for Internationally Wrongful Acts, art. 4 (2001), <https://www.ilsa.org/jessup/jessup17/Batch%201/Articles%20of%20Responsibility%20of%20States%20for%20Internationally%20Wrongful%20Acts.pdf>.

¹⁹⁴Article 5 (Conduct of persons or entities exercising elements of governmental authority) provides that:

The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance.”

See *id.*, art. 5.

¹⁹⁵See G.A. Res. 2625 (XXV), Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations (Oct. 24, 1970), <http://www.un-documents.net/a25r2625.htm>.

¹⁹⁶See Kazuhiro Nakatani, *Sovereign Wealth Funds: Problems of international law between possessing and recipient States*, 2015 INT’L REV. L. 1, 7 (2015).

lack legal jurisdiction over the acts of target companies in host countries, exclusions and divestment may effectively function as extra-judicial punishment in ways that violate principles of fairness and justice, especially where the home country of the target company has not accused or penalized the company. Further, it is not generally feasible for these target companies to rebut the accusations or condemnation of the SWFs.

The techniques of exclusion through negative screening and divestment can easily be used as political tools, not legal methods. In the long term, shareholder activism through active engagement can be a better way for SWFs to improve the corporate governance of target companies and promote sustainable development.

5.3 Violation of soft law regulation

The third question concerns whether SWFs adopting SRI strategies or undertaking responsible investment could go against the soft law regulating SWFs, i.e., the Santiago Principles. Among other things, the Principles require SWFs to use investment strategies that result in moderate financial risk, to have a sound legal and governance structure, to operate transparently, and to build risk management frameworks.¹⁹⁷ However, the Santiago Principles do not explicitly mention responsible investment or ESG considerations. The Santiago Principles only stipulate maximizing financial returns based on financial grounds but do not mention social returns.

Nevertheless, there are some principles that imply that considering ESG factors and implementing responsible investment strategies in investment policies are generally acceptable. Principle 19.1 stipulates that “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.”¹⁹⁸ This demonstrates that SWFs can adopt SRI strategies as long as they publicly disclose relevant considerations.

The Santiago Principles have also recognized the value of shareholder ownership rights. As an important strategy of responsible investment, shareholder activism seems acceptable according to the Principle 21, which states “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 investment.”¹⁹⁹ Also, the SWF voting record should be publicly disclosed. Hence, a high level of transparency is required here for practicing SRI. Principle 22 also mentions the risk management framework of SWFs, especially reputational risk management, to avoid a decrease in financial returns and also avoid undermining the reputation of home countries.²⁰⁰ This suggests that use of SRI strategies should ensure the financial value of the investment.

The Santiago Principles set conditions and limits for SWFs to undertake SRI but do not require or forbid actions. In practice, the responsible investment activities of the GPFG and the NZSF's have been acknowledged by the International Forum of Sovereign Wealth Funds (IFSWF),²⁰¹ the organization whose

¹⁹⁷See *Santiago Principles*, *supra* note 67.

¹⁹⁸*Id.*

¹⁹⁹*Id.*

²⁰⁰*Id.*

²⁰¹The International Forum of Sovereign Wealth Funds was established by IWG in 2009 and it has replaced the IWG to continue the mission of facilitating an understanding of the Santiago Principles and SWFs activities. For more information, see International Forum of Sovereign Wealth Funds, *About IFSWF*, <http://www.ifswf.org> (last visited May 1, 2016).

members endorse the Principles, in its report.²⁰² Therefore, it appears SWFs could adopt SRI into their investment policies as long as they publicly disclose their SRI strategies and practices, build a well-functioning risk management framework, and do not jeopardize financial returns.

5.4 Political influence and accountability

The fourth question concerns the accountability of SWFs' responsible investment and political influence. Although the political influence of the sponsor of SWFs is criticized or suspected by scholars, the major issue concerning SRI activities is the issue of accountability. There are concerns that the politics or the governance structure of SWFs may influence asset allocation decisions or change their investment strategies.

However, it can be argued that political motivations are acceptable to a certain extent when discussing SWFs adopting SRI, for at least three reasons. First, although SWFs invest for financial returns, they are established to pursue various macroeconomic or social welfare goals, and even to assume responsibility for future generations.²⁰³ While these goals may involve political considerations,²⁰⁴ SWF investment concentrating on financial returns is used to guarantee the fulfillment of social goals. The initial goal concerning social returns is set by their governments, while the operational goals during their daily transactions are based on financial considerations managed by professional external asset managers or advisors.²⁰⁵

Moreover, the Santiago Principles, as best practices for SWFs, also support this argument. They illustrate that the investment policies of a SWF should be in line with designated goals set by its owner or governor based on sound management principles.²⁰⁶ These policy purposes guide the asset management and investment strategy of SWFs. Furthermore, with regard to the SWFs analyzed in this article, their SRI practices are supported by their governments via legal mandate or political policy. The investment of Norwegian SWF GPFG is even regarded as an instrument helping to consolidate public value (political power) and private value (financial returns maximization) through global markets, which demonstrates the importance of public policy in private investment.²⁰⁷ The GPFG uses its ownership rights to bring the public policy of Norway to target companies to produce income, and these policies in turn reflect the government regimes of both international law and Norwegian national rules.²⁰⁸

As for accountability, SWFs face very limited regulatory constraints or investor scrutiny in their selection of investment strategies. The governance structure of SWFs and their level of transparency could influence or even hinder the way they practice SRI and fulfil their fiduciary duty.²⁰⁹ Although some SWFs are separate from their governments, a majority of SWFs keep close ties with their governments, some of which have political leaders on the board that controls the SWF decision-making power. The political

²⁰²See International Forum of Sovereign Wealth Funds, *IFSWF Members' Experiences in the Application of the Santiago Principles*, http://www.ifswf.org/sites/default/files/Publications/stpo70711_o.pdf (July 7, 2011).

²⁰³See Clark & Knight, *supra* note 100.

²⁰⁴GAPP 18. See *Santiago Principles*, *supra* note 67.

²⁰⁵See Samuele Murtinu & Vittoria G. Scalera, *Sovereign Wealth Funds' Internationalization Strategies: The Use of Investment Vehicles*, 22 J. INT'L MGMT. 249, 261 (2016); see also Udaibir S. Das et al., *Setting up a Sovereign Wealth Fund: Some Policy and Operational Considerations*, 18 (IMF Working Paper WP/09/179, 2009).

²⁰⁶*Id.*

²⁰⁷See Backer, *supra* note 127.

²⁰⁸*Id.* at 95.

²⁰⁹See Richardson, *Sovereign Wealth Funds*, *supra* note 9, at 162.

influence may change the investment strategies and policies of SWFs, as well as influence their investment decisions.²¹⁰ Also, the investment decisions of SWFs are regarded as commercial behaviour that cannot be regulated by judicial review. It can also be argued that the investment decisions by SWFs face limited regulatory constraints and investment scrutiny, thus leading to limited legal accountability to the public.²¹¹ Therefore, even if investment decisions are wrong or cause losses, their beneficiaries (citizens) have no available way to ask for remedies.

As for implementation of SRI measures, because some home countries of SWFs do not have legally enforceable standards or explicit legal mandates, it is hard to measure or judge whether SWFs have fulfilled their public fiduciary duty or not.

In light of these concerns, if other SWFs intend to adopt SRI or consider ESG in decision-making, a more independent and commercial governance structure and more comprehensive legal support are needed and indispensable. For example, SWFs can delegate rights to experts and external managers;²¹² reduce political influence on the board; improve transparency according to the Santiago Principles, and reform domestic regulations involving international agreements and international voluntary guidelines.

6. Conclusion

This paper has described the issues associated with implementation of SRI by SWFs. It has shown that international regulations, i.e., international conventions and soft law, encourage or allow SWFs to adopt SRI strategies and take ESG factors into consideration. Among existing SRI strategies, shareholder activism, active engagement in particular, can positively influence the conducts of target companies and promote CSR. It has been found that since SRI is a trend within institutional investors groups, if SWFs adopt SRI, it will reduce certain concerns from host countries and improve their reputation in the international community. In sum, implementing SRI by SWFs can make a positive impact on their financial and social returns, as well as on those of the target companies, and thus, in turn, positively affect the sustainability of financial markets.

Looking back to the beginning of this article, two important questions were put forward. The first one concerned the need to undertake SRI strategies by SWFs, and the second question concerned the way to undertake SRI strategies by SWFs. This paper has answered the first question by analysing the general underpinnings for promoting SRI and the specific underpinnings for SWFs' SRI action. It has found that adopting SRI strategies can benefit SWFs and influence the corporate behaviour of target companies. This paper has answered the second question by assessing selected examples of SWFs that have practiced SRI with or without legal mandate support, followed by examining legal issues when considering the implementation of SRI by other SWFs. This paper has found that the objective of implementing SRI by SWFs is to influence the corporate governance of target companies and thus guarantee their long-term financial returns will not be undermined by ESG externalities. To practice SRI, SWFs should act in accordance with relevant national and international rules (including the Santiago Principles) or structure reasonable investment policies or principles.

²¹⁰See Dyck & Morse, *supra* note 193.

²¹¹See Benjamin J. Richardson, *International Environmental Law and Sovereign Wealth Funds*, in INT'L ENVTL. L. & THE GLOBAL SOUTH 377 (Shawkat Alam et al., eds., 2015).

²¹²See Das, *supra* note 207, at 18.

As for all SWFs, when implementing SRI strategies, first, they should provide sound governance structures and legal mandates or mechanisms sufficient to guarantee their accountability and responsibility. Second, they should increase their level of transparency because transparency is required when SWFs consider non-financial factors in their portfolio or implement SRI. These requirements cannot work without a systematic regulatory framework. It can be suggested that to effectively promote SRI, SWFs should act within a framework incorporating binding mandatory regulations, workable ethical codes, and reasonable remedial measures. Because the investment strategies of SWFs involve an interaction between a political economy and purely financial concerns, future research on implementation of SWFs should consider the operational and governmental structure of individual SWFs. Further research remains to be conducted to assess how SRI by SWFs influences the corporate behaviours and financial performance of target companies.
