



الهيئة العامة للاستثمار
Kuwait Investment Authority

KUWAIT INVESTMENT AUTHORITY

KIA's Implementation of the Santiago Principles
[Generally Accepted Principles and Practices]

IFSWF CASE STUDY

Three Pillar Format

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PILLAR I – LEGAL FRAMEWORK, OBJECTIVES AND COORDINATION WITH MACROECONOMIC POLICIES

In this section, KIA's application of the principles falls under the "Pillar I – Legal Framework, Objectives and Coordination with Macroeconomic Policies" is examined. Three separate aspects of Pillar I is studied:

- **LEGAL FRAMEWORK**
- **OBJECTIVES**
- **COORDINATION WITH MACROECONOMIC POLICIES PILLAR I – LEGAL FRAMEWORK**

INTRODUCTION: KUWAIT INVESTMENT AUTHORITY

ORIGIN:

- **The Kuwait Investment Authority (KIA)** is the oldest sovereign wealth fund in the world. KIA traces its roots to the Kuwait Investment Board established in 1953, eight years before Kuwait's independence.
- In 1982, KIA was created as an autonomous governmental body responsible for the management of the assets of the country.

MISSION STATEMENT:

“To achieve a long term investment return on the financial reserves entrusted by the State of Kuwait to the Kuwait Investment Authority, providing an alternative to oil reserves which would enable Kuwait's future generations to face the uncertainties ahead with greater confidence.”

PILLAR I – LEGAL FRAMEWORK

LEGAL ESTABLISHMENT:

- KIA traces its roots to the Kuwait Investment Board that was established in 1953, eight years before Kuwait's independence.
- In 1982, KIA was created by Law No. 47 as an autonomous governmental body responsible for the management of the assets of the country. Law 47, Article 1 states:
- “An independent public authority shall be established with juridical status to be named the “Kuwait Investment Authority” and be attached to the Minister of Finance. The seat of the authority shall be in the State of Kuwait and it may set up offices outside the State of Kuwait.”
- Source of Funds:
- KIA is responsible for the management of Kuwait's General Reserve Fund (GRF) and its Future Generations Fund (FGF), as well as other funds entrusted to it by the Minister of Finance for and on behalf of the State of Kuwait.
- The GRF is the main treasurer for the Government and receives all revenues (including all oil revenues) from which all State budgetary expenditures are paid.
- The FGF was established in 1976 with 50% of the GRF Balance. It receives a minimum of 10% of all State revenues as well as 10% of the net income of GRF on an annual basis.

PUBLIC DISCLOSURE:

- KIA's investments are completely transparent to the State of Kuwait, which is responsible for protecting the interests of KIA's beneficiaries – the citizens of Kuwait.
- Kuwait's parliament, the National Assembly, is freely elected by all Kuwaiti citizens 21 or older. The elected representatives of the National Assembly are regularly informed, at least annually, of KIA's investments and investment performance.
- KIA also provides regular and frequent reports to the following concerned parties:
- The Minister of Finance
- The Council of Ministers
- KIA's Board of Directors
- The Chairman and the Executive Committee of KIA's Board of Directors
- The Independent State Audit Bureau (whose on-site personnel also provides an ongoing monitoring).
- Senior representatives of KIA report periodically to the National Assembly's various committees (including the Finance and Economic Committee; Budgetary and Closing Accounts Committee; and Public Funds Protection Committee) to discuss any issues raised by the State Audit Bureau.

KIA'S OBJECTIVES:

Pillar I – Legal Framework

- Law 47, Article 2 outlines the objective of KIA as:
- *“The objective of the Authority is to undertake, in the name and for the account of the State of Kuwait, the management of the General Reserve Fund, the monies allocated for the Future Generations Fund, as well as such other monies that the Minister of Finance may entrust the Authority with its management.”*
- **KIA’s objectives are transparent to its stakeholders and disclosed on its website (click here).**
- **KIA aims to achieve a rate of return on its investment that, on a three-year rolling average, exceeds its composite benchmarks by:**
 - Designing and maintaining an asset allocation consistent with its mandated return and risk objectives.
 - Selecting investments and investment managers with the ability to outperform the respective index for each asset class.
 - Making tactical changes to the asset allocation without adversely altering the aggregate so as to benefit from emerging economic and market trends.
- **KIA endeavors to be a world-class investment management organization committed to continuous improvement in the way it conducts business by:**
 - Holding itself to performance standards comparable with those of its peer group of large investment bodies, endowments or pension funds worldwide.
 - Staying properly informed of best practices in the investment community through continuous training and development of its staff.
 - Developing and maintaining an organizational culture that is dynamic and motivates personnel to constantly seek improvement in the investment process.
- **KIA is committed to the excellence of the private sector in Kuwait while ensuring that it does not compete with or substitute for it in any field. Towards this goal, KIA will:**
 - Contribute to the formation of human capital in Kuwait by attracting talented and ambitious young Kuwaitis, training and preparing them to become the best investment professionals in the market.
 - Participate in the growth of the investment sector in Kuwait by doing business with the best performing companies and investing in their creative ideas.
 - Reinforce sound corporate governance, transparency in all operations, and fair business dealings in Kuwait by holding our business associates and portfolio companies to the highest ethical standards.

PILLAR I – COORDINATION WITH MACROECONOMIC POLICIES

KIA'S ROLE IN THE LOCAL ECONOMY

- KIA plays a pivotal role in the local economy. It directs and manages the State's contributions and shares in various major economic entities.
 - KIA maintains an active involvement with economic and financial developments in Kuwait. It promotes and supports institutionalization of the market through setting up funds and companies to promote and finance local business, and participates in the launching of local investments that have feasible economic returns.
 - KIA helps develop the role of local financial companies by giving them the opportunity to manage some of its investments locally and abroad. The private sector's regeneration will be maintained through privatization programs that KIA is committed to undertake.
 - KIA provides liquidity to the State's Treasury when needed.
 - KIA has set up several companies in the last few years as a requirement by a statute enacted by the Kuwait's National Assembly (Parliament), primarily to promote investment in Kuwait
- KIA's role in the local economy is disclosed on its website.

PILLAR II – INSTITUTIONAL ARRANGEMENTS AND GOVERNANCE STRUCTURE

In this section, KIA's application of the principles falls under the "*Pillar II – Institutional Arrangements and Governance Structure*" is examined. Two separate aspects of Pillar II is studied:

- **INSTITUTIONAL ARRANGEMENTS**
- **GOVERNANCE STRUCTURE**

PILLAR II – INSTITUTIONAL ARRANGEMENTS

Overview of Funds: KIA is responsible for the management of Kuwait's General Reserve Fund (GRF) and its Future Generations Fund (FGF), as well as other funds entrusted to it by the Minister of Finance for and on behalf of the State of Kuwait.

General Reserve Fund (GRF):

The GRF is the main treasurer for the Government and receives all revenues (including all oil revenues) from which all State budgetary expenditures are paid. The GRF also holds all government assets, including Kuwait's participation in public enterprises as well as Kuwait's participation in multilateral and international organizations.

Future Generation Fund (FGF):

The FGF was created in 1976 by transferring 50% from the GRF at that time. In addition, a minimum of 10% of all state revenues are transferred to the FGF on an annual basis and all investment income is reinvested. The FGF consists of investments outside Kuwait based on an approved Strategic Asset Allocation in various asset classes. KIA's asset allocation process is based on World GDP contributions and Market Capitalizations. Exceptions to this rule are those countries where the weighting was skewed due to core holdings such as BP and Daimler.

Withdrawals:

- As mentioned previously, the GRF is the repository of all income of the State of Kuwait. Accordingly all State budget expenditures are paid out of the GRF. The transfers from the GRF to pay the State budgetary expenditures are sanctioned by law.
- No assets can be withdrawn from the FGF unless sanctioned by law. All investment income are reinvested as required by Law No. 106 of 1976.
- The only exception for the FGF was withdrawal of funds during the Iraqi invasion and occupation in 1990/1991 where funds are withdrawn from the FGF to pay for the cost of liberation and subsequent reconstruction. Nearly \$85 billion were withdrawn from the FGF during 1990 until 1994. In any event, all amounts of funds which were withdrawn were fully repaid to the FGF.

Borrowing:

- Kuwait's Constitution prohibits KIA from borrowing unless it is enacted by a specific law. However, KIA's holdings in companies is not subject to such prohibition.

Ownership Responsibilities:

- KIA does not seek to purchase majority or controlling interests in the companies in which it invests, other than shares in real estate investment entities and in investment holding companies that it establishes for particular transactions.

Voting Rights:

- KIA exercises its voting rights in the manner that it believes will protect the financial interests of KIA, and to the extent KIA votes for the election of any Board members of a portfolio company, such Board member will be subject to all the obligations of Board members under applicable laws.

Relationship with the Private Sector:

- KIA operates as a responsible and generally passive investor and when KIA competes with other investors in the global market place, it is subject to the laws and regulations applicable to all such investors in the jurisdictions in which KIA invests in.
- KIA is committed to the excellence of the private sector in Kuwait while ensuring that it does not compete with or substitute for it in any field.

PILLAR II – GOVERNANCE STRUCTURE

BOARD OF DIRECTORS:

- KIA is an independent public authority managed by its Board of Directors.
- The Board has complete independence in its decision making process.
- By law, the Board members consists of:
 - The Minister of Finance (Chair) [Ex-officio]
 - The Minister of Oil [Ex-officio]
 - The Governor of the Central Bank of Kuwait [Ex-officio]
 - The Under Secretary of the Ministry of Finance [Ex-officio]
 - And five other Kuwaiti Nationals from the private sector appointed by Amiri Decree
- At least three of the private sector appointees may not hold any other public office.

MANAGING DIRECTOR AND EXECUTIVE COMMITTEE:

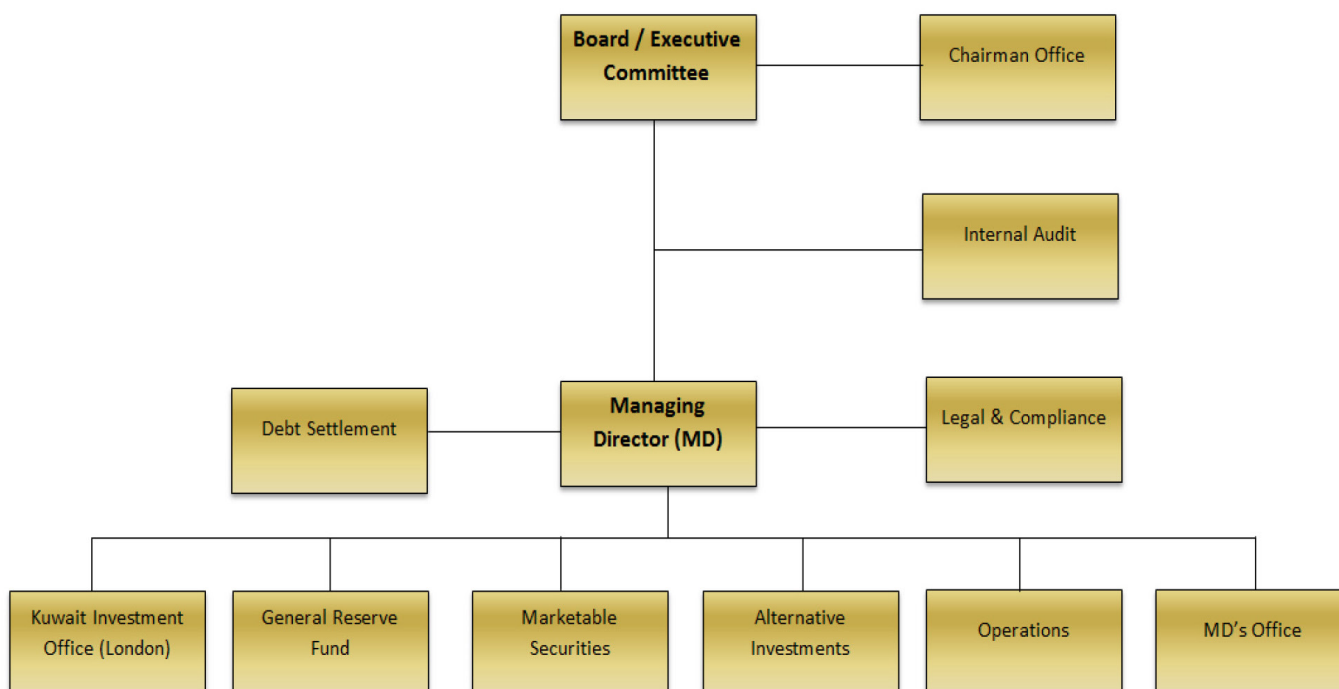
- The Board selects a Managing Director and his deputies, who may not (during their respective terms of office) undertake any work, with or without pay, for any employer other than KIA.

Pillar II – Institutional Arrangements and Governance Structure

- The Board also appoints an Executive Committee that is composed of five Board members, of whom at least three are taken from private sector appointees to the Board and that is chaired by the Managing Director.
- The primary role of the executive committee is to assist the Board of Directors in setting the strategic goals and objectives of KIA.

GOVERNANCE STRUCTURE

KIA'S ORGANIZATIONAL STRUCTURE



PILLAR II – GOVERNANCE STRUCTURE

EXTERNAL AUDIT:

KIA's managed accounts are jointly audited annually by two of the "Big Four" independent audit firms. The External Auditor reports directly to the Board of Director of KIA.

BOARD AUDIT COMMITTEE

- There is a Board Audit Committee comprising of two private sector Board members. The Board Audit Committee is chaired by the Under Secretary of the Ministry of Finance. The Managing Director is invited to attend the Board Audit Committee meetings as an observer.

Pillar II – Governance Structure

THE STATE AUDIT BUREAU:

- KIA is required by law to submit semi annual statements of its assets under management to the independent State Audit Bureau, which also assigns on-site personnel to review KIA’s activities on an ongoing basis.

INTERNAL AUDIT:

- In addition to the external auditors, KIA has an Internal Audit Office that reports directly to the Chairman of the Board of Directors. Internal Audit Department conducts regular audits for all KIA departments.

CIVIL SERVICE COMMISSION

- The Civil Service Commission assigns on-site personnel to ensure KIA’s compliance with all administrative and human resources requirements as a public sector entity.

MINISTRY OF FINANCE

- The Ministry of Finance assigns on-site Controllers to ensure that all administrative expenditures are in compliance with internal rules and regulations and is within approved guidelines.

PILLAR III – INVESTMENT AND RISK MANAGEMENT FRAMEWORK

In this section, KIA’s application of the principles falls under the “Pillar III – Investment and Risk Management Framework” is examined. Two separate aspects of Pillar III is studied:

- **INVESTMENT POLICY FRAMEWORK**
- **RISK MANAGEMENT FRAMEWORK**

INVESTMENT POLICY FRAMEWORK

INVESTMENT CONSIDERATIONS:

- KIA is a commercial driven entity.
- KIA invests only in the projects which have clearly defined profitability targets.
- KIA does not invest in sectors where gaming and alcohol-related activities constitute the main source of business.

INVESTMENT HORIZON:

- KIA has a long term investment horizon and has the ability to bear risk and accommodate short term volatility, hence it is a force for stability in financial markets.

Leverage:

- KIA does not borrow for investment purposes as this is prohibited by the Kuwait's Constitution.
- KIA does not use any derivative products as investment vehicles.

Investment Platform:

- KIA invests funds through External Fund Managers out of Kuwait.
- Kuwait investment Office in London trades directly.

Specialized Companies:

- The KIA has created a series of specialized standalone entities to invest in certain asset classes on its behalf. Some of these entities are as follows:
 - St. Martins for real estate investments in UK and global. Based in London, UK.
 - Fosterlane/Breadstreet for real estate investments in the USA. Based in Atlanta, USA.
 - Wren House Infrastructure for brownfield infrastructure investments in UK and global. Based in London, UK.

PILLAR III – INVESTMENT AND RISK MANAGEMENT FRAMEWORK

INVESTMENT OBJECTIVES AND STRATEGIES:

- KIA has clear guidelines and a strategy in terms of asset allocation (both regional and asset class), that are regularly reviewed and updated.
- KIA aims to achieve a rate of return on its investment that, on a three-year rolling average, exceeds its composite benchmarks by:
 - Designing and maintaining an asset allocation consistent with its mandated return and risk objectives.

Pillar III – Investment and Risk Management Framework

- Selecting investments and investment managers with the ability to outperform the respective index for each asset class.
- Making tactical changes to the asset allocation without adversely altering the aggregate so as to benefit from emerging economic and market trends.

CAPITAL FLOWS:

- FGF: By law, a minimum of 10% of the all State revenues as well as 10% of the net GRF Income are transferred to the FGF annually. All proceeds from the FGF's investments are reinvested again by law and any transfer from the FGF requires a specific legislation authorizing any withdrawal. The FGF is the intergenerational saving platform managed by the KIA.
- GRF: Being the general reserve of the State of Kuwait, GRF assets and the income are available for use by the State of Kuwait as determined by the Government through passage of an annual budget by Parliament. The GRF is the treasurer as well as the stabilization fund managed by the KIA.

PILLAR III – INVESTMENT AND RISK MANAGEMENT FRAMEWORK

FGF INVESTMENT STRATEGY

OVERVIEW:

- The FGF has a KIA Board approved investment strategy that outlines the guidelines in parallel with the risk and return objectives of the fund.

PERIODIC REVIEW:

- The investment strategy is regularly reviewed and updated based on the changing economic and financial factors and expectations.

FUND PROFILE:

- The FGF is a long term investor in various asset classes ranging from more traditional assets such as equities and bonds to alternatives such as private equity, real estate and infrastructure.
- The FGF assets are managed by KIA's Kuwait and London offices based on the Board approved split.

EXTERNAL/INTERNAL FUND MANAGEMENT

- External Fund Managers (EFMs): KIA's Kuwait office appoints global leading EFMs to manage various mandates (especially for equities, fixed income and cash asset classes).
- Kuwait Investment Office (KIO): KIA manages a portion of its assets directly through KIO in London.
- Alternatives: KIA also invests directly in private equity funds and hedge funds with the assistance of third party advisors.

Pillar III – Investment and Risk Management Framework

- Core Holdings: In select cases, KIA directly invests in equities classified as Core Holdings, such as its holdings in BP and Daimler.

STRATEGIC ASSET ALLOCATION (SAA):

- Regional Allocation: The FGF invests outside of Kuwait and the MENA countries. The SAA established by the Board of Directors sets out allocations to the regions of the world.
- Asset Allocation: The SAA includes allocations to the various assets classes such as equities, fixed income, real estate, alternatives and cash.
- Mandate Allocation: The SAA also goes further to specify allocations to various styles in all asset classes.
- Both internally and externally managed assets are managed based on the guidelines set out in the SAA and are measured accordingly.

OVERVIEW:

- The GRF is the main repository of all of the State of Kuwait's oil revenues and income earned from GRF investments.
- Its assets and the income therefrom are available for use by the State of Kuwait as determined from time to time by the government of Kuwait, based on annual budgets approved by Kuwait's National Assembly (Parliament).
- On annual basis a minimum of 10% of all State Revenues and 10% of the net income of the GRF are transferred to the FGF.
- The State must authorize all withdrawals from the GRF through passage of annual Budget.

REGIONAL ASSET ALLOCATION:

- The GRF consists of investments in Kuwait and other MENA countries as well as hard currency assets held by KIA on behalf of the State of Kuwait.
- The GRF also holds other government assets, including Kuwait's participation in public enterprises such as the Kuwait Fund or Arab Economic Development and Kuwait Petroleum Company in addition to Kuwait's participation in multilateral and international organizations, including the World Bank, the International Monetary Fund and the Arab Fund for Economic and Social Development, amongst others.

OVERVIEW:

- The Board, Executive Committee of the Board and Senior Management are provided with a comprehensive Risk and Performance Management tools and reports to make informed decisions and assess KIA's investment performance and risk exposures against preset targets in the strategy.
- Since 2008, KIA centralized investment performance and risk management function within Risk Management and Performance Measurement Unit, which reports directly to the Managing Director.
- KIA's performance and risk management systems and processes are subject to the review by the two independent accounting firms that audit KIA.

RISK MANAGEMENT AND PERFORMANCE MEASUREMENT UNIT (RPU):

- KIA's investment performance and risk management is the responsibility of the RPU. The RPU has following responsibilities:
- Conducting performance and risk analysis.
- Identifying and communicating performance and risk issues to senior management.
- Developing an understanding of performance and risk within the KIA's investment sectors.
- Investigating data irregularities.
- Educating KIA staff on performance and risk by explaining the Unit's own work and answering questions as required.
- Ensure the Unit's output is clear and has explanatory detail as required to aid understanding.

RPU OUTPUT

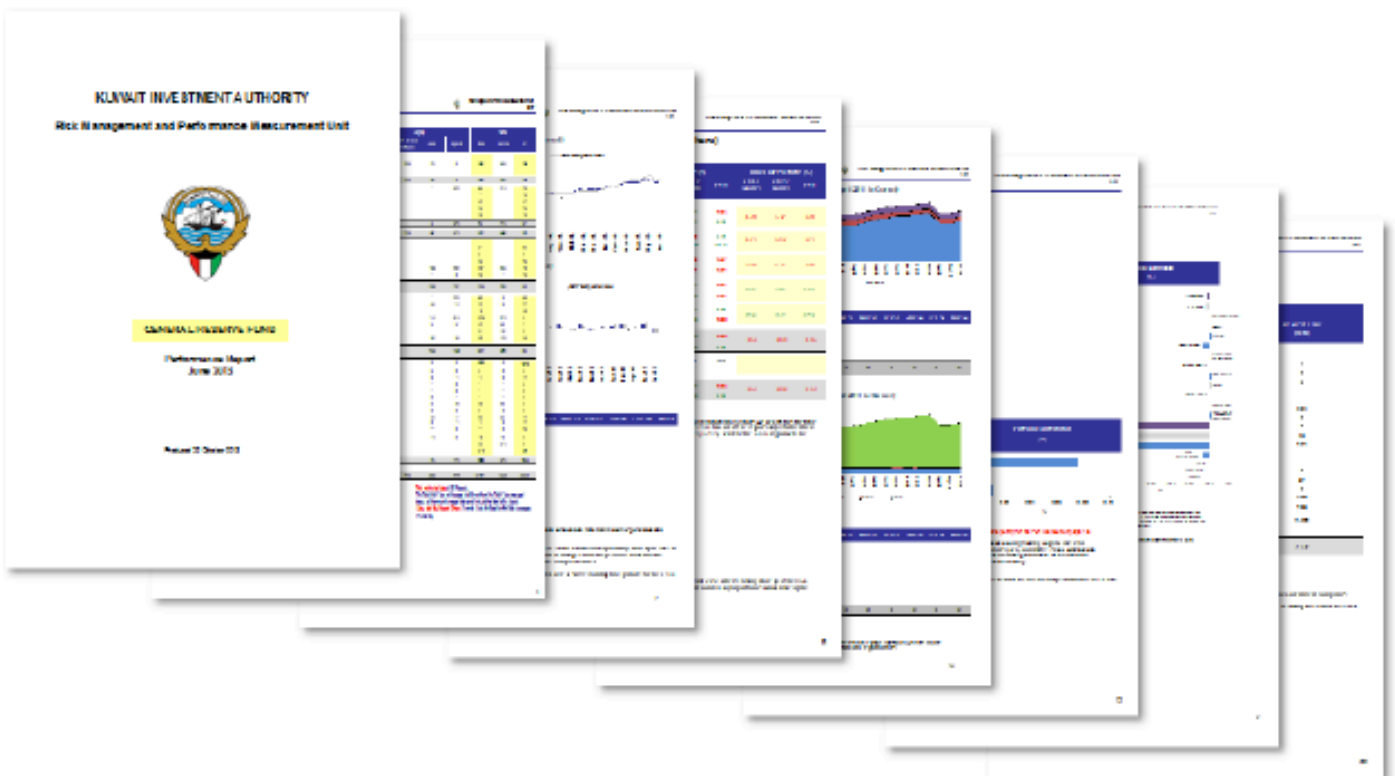
- Following section includes samples of the regular output that the RPU produces for the Board, the Executive Committee of the Board and for the Senior Management of KIA.

On a quarterly basis, the RPU calculates and reports performance of the total FGF and GRF as well as various composites and mandates based on Global Investment Performance Standards (GIPS). Some sample pages from a FGF performance report are shown below:

The collage displays several pages from a performance report for the Future Generations Fund (FGF) as of September 2009. The pages include:

- Page 1:** A table titled "Total Portfolios" listing various investment vehicles such as "Total Equity", "Total Fixed Income", and "Total Real Estate".
- Page 2:** A table titled "FGF Returns" showing performance metrics for different asset classes, including "Total FGF", "Total Equity", "Total Fixed Income", and "Total Real Estate".
- Page 3:** An "Overview" section with a table of key performance indicators (KPIs) such as "Capital", "Fixed Income", "Real Estate", and "Cash".
- Page 4:** The header for the "KUWAIT INVESTMENT AUTHORITY FUTURE GENERATIONS FUND TOTAL" performance report, featuring the KIA logo.
- Page 5:** The title "Performance Report September 2009" and the production date "Produced 24 November 2009".

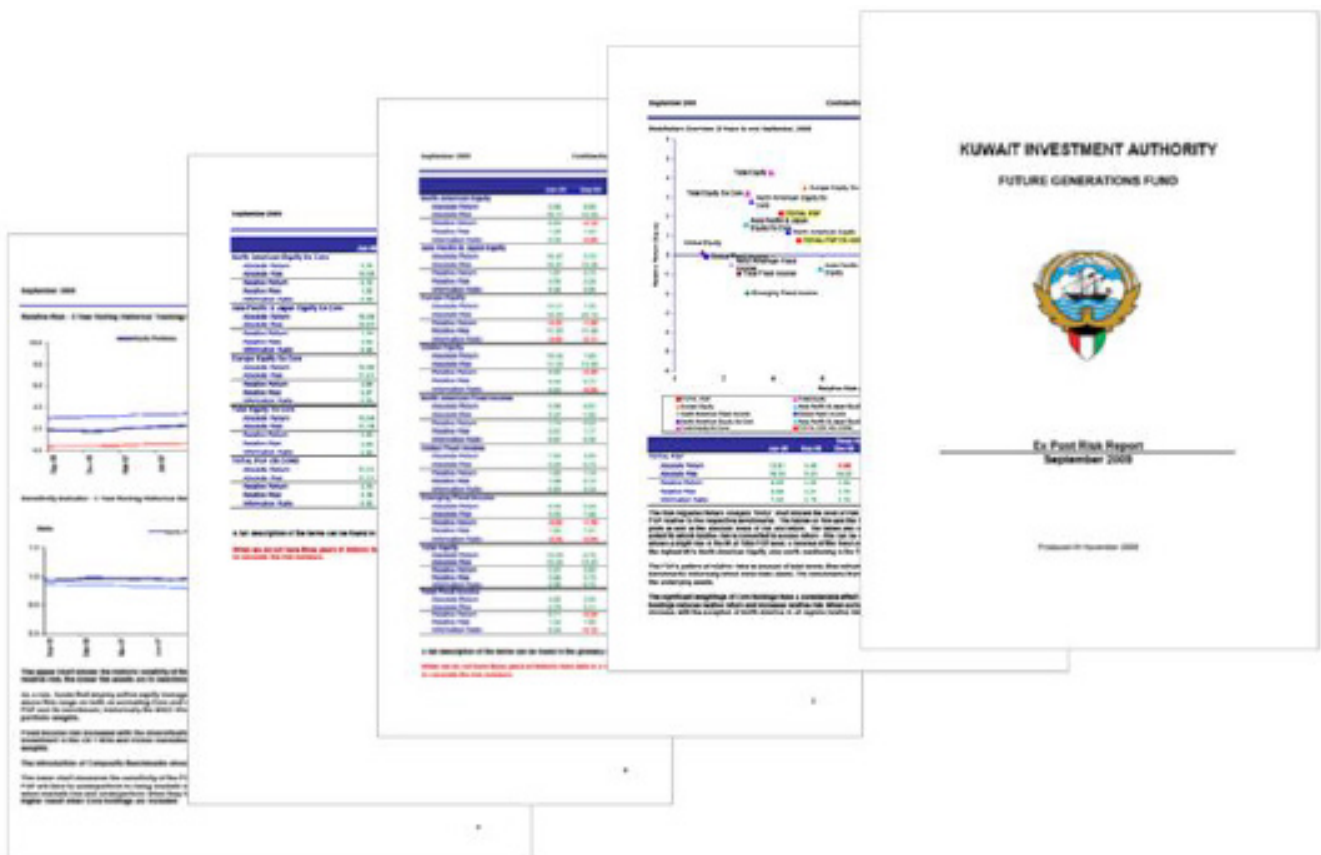
On a quarterly basis, the RPU calculates and reports performance of the total FGF and GRF as well as various composites and mandates based on the GIPS. Some sample pages from a GRF performance report are shown below:



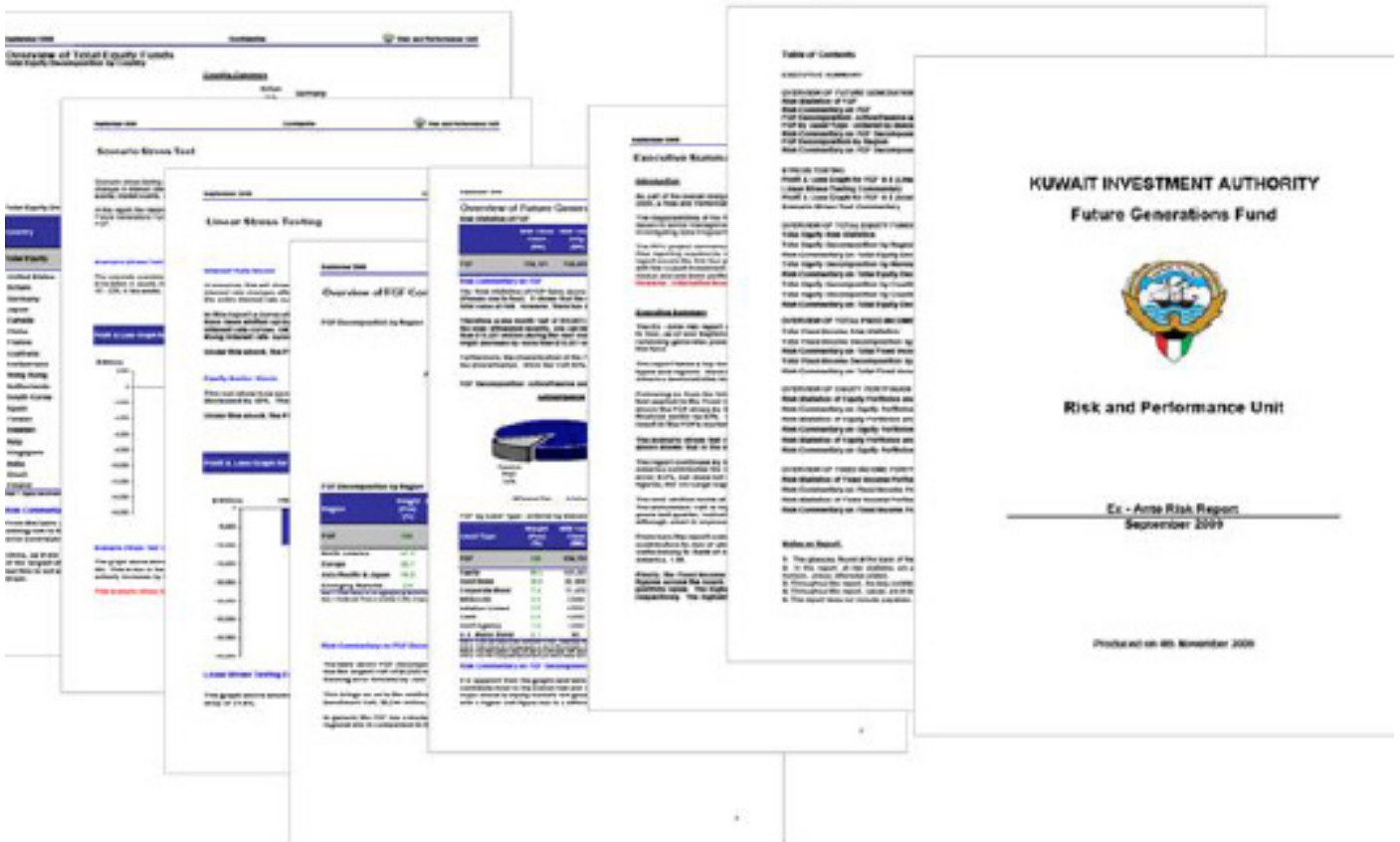
On a monthly basis, the RPU collates and ranks all of the external fund managers (including the KIO) based on the relative performance for both the FGF and the GRF.

The image displays several overlapping financial reports and performance charts. At the top right, a 'Month 2020' summary shows 'Absolute Return' and 'Asset Allocation'. Below it, a 'Future Performance' table lists various fund managers and their assets. To the left, a 'Portfolio Performance' table provides a detailed view of portfolio returns. On the right, the logo of the Kuwait Investment Authority Future Generations Fund is visible, featuring a globe and the text 'KUWAIT INVESTMENT AUTHORITY FUTURE GENERATIONS FUND'. The bottom right corner shows a 'Portfolio Performance Rankings' section with a color-coded bar chart.

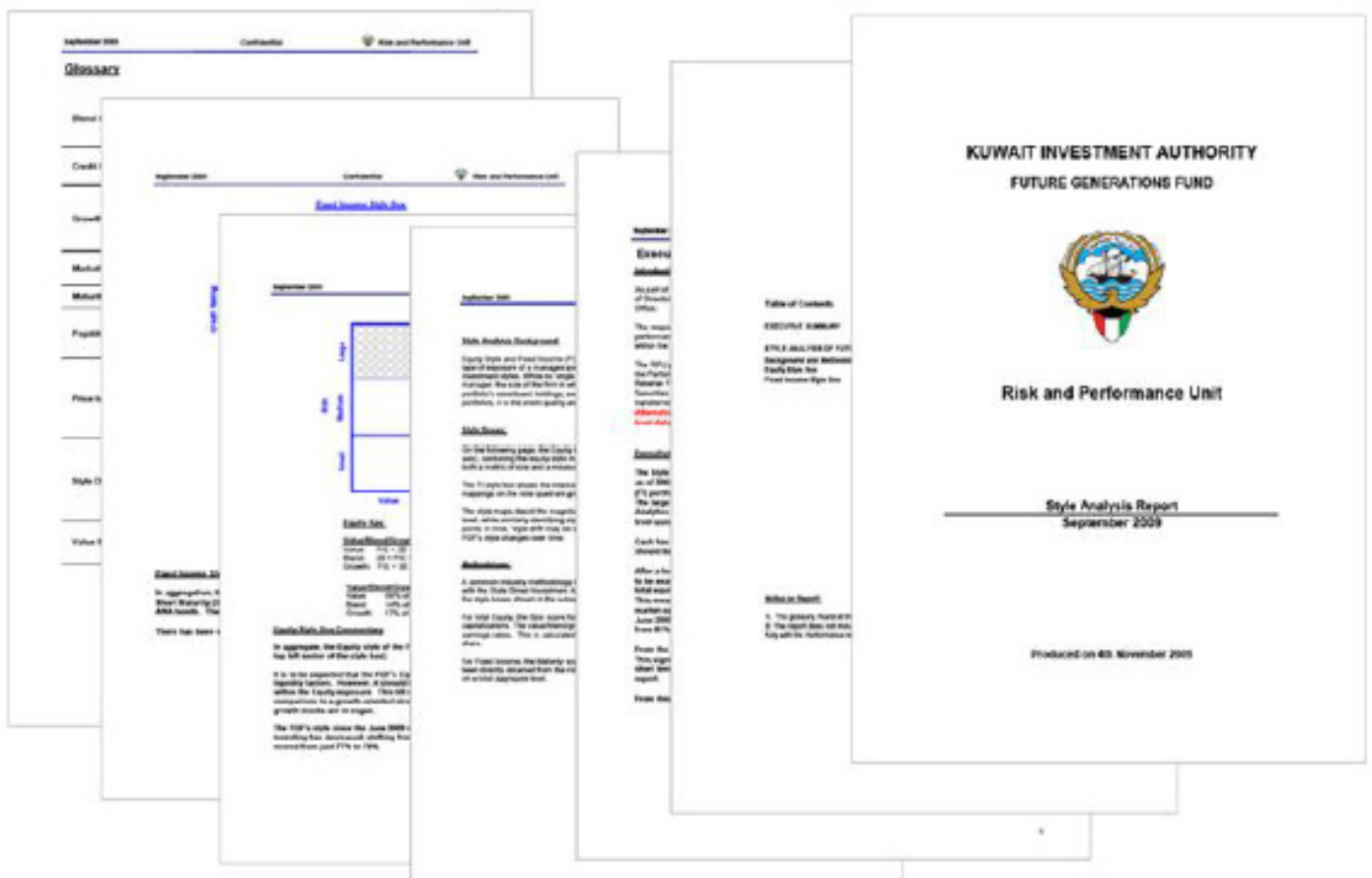
On a quarterly basis, the RPU produces ex-post risk reports with various risk and risk adjusted return statics including Tracking Error, Information Ratio, Standard Deviation, Sharpe Ratio and Beta. Some sample pages from a FGF ex-post risk report are shown below:



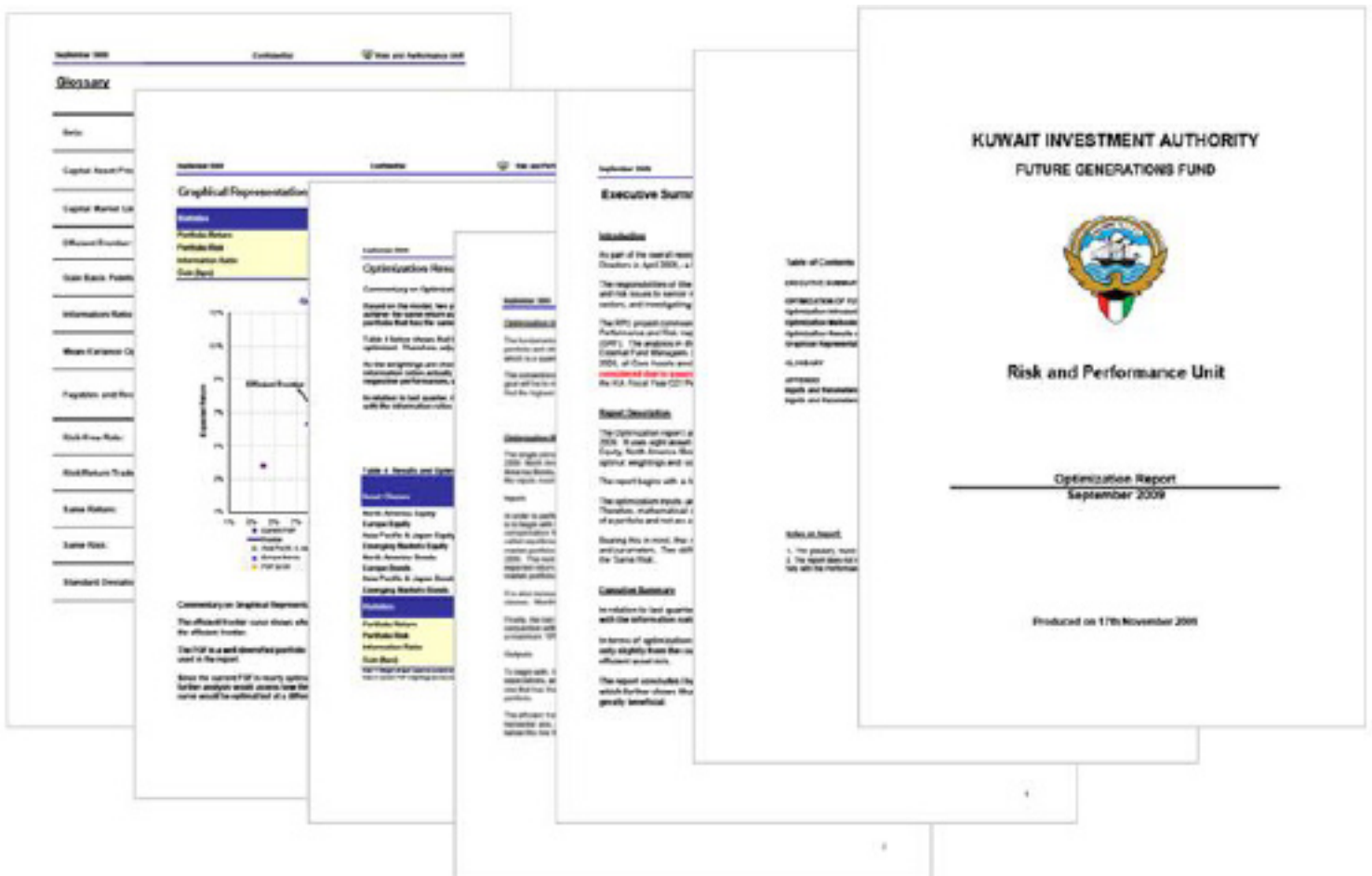
On a quarterly basis, the RPU produces ex-ante risk reports with various ex-ante risk statistics such as VAR, Diversification Impact, Ex-ante Tracking Error as well as risk analysis such as Risk Exposure Reporting, Stress Tests, Extreme Tail Risk Analysis and Two Way Risk Decomposition. Some sample pages from a FGF ex-ante risk report are shown below:



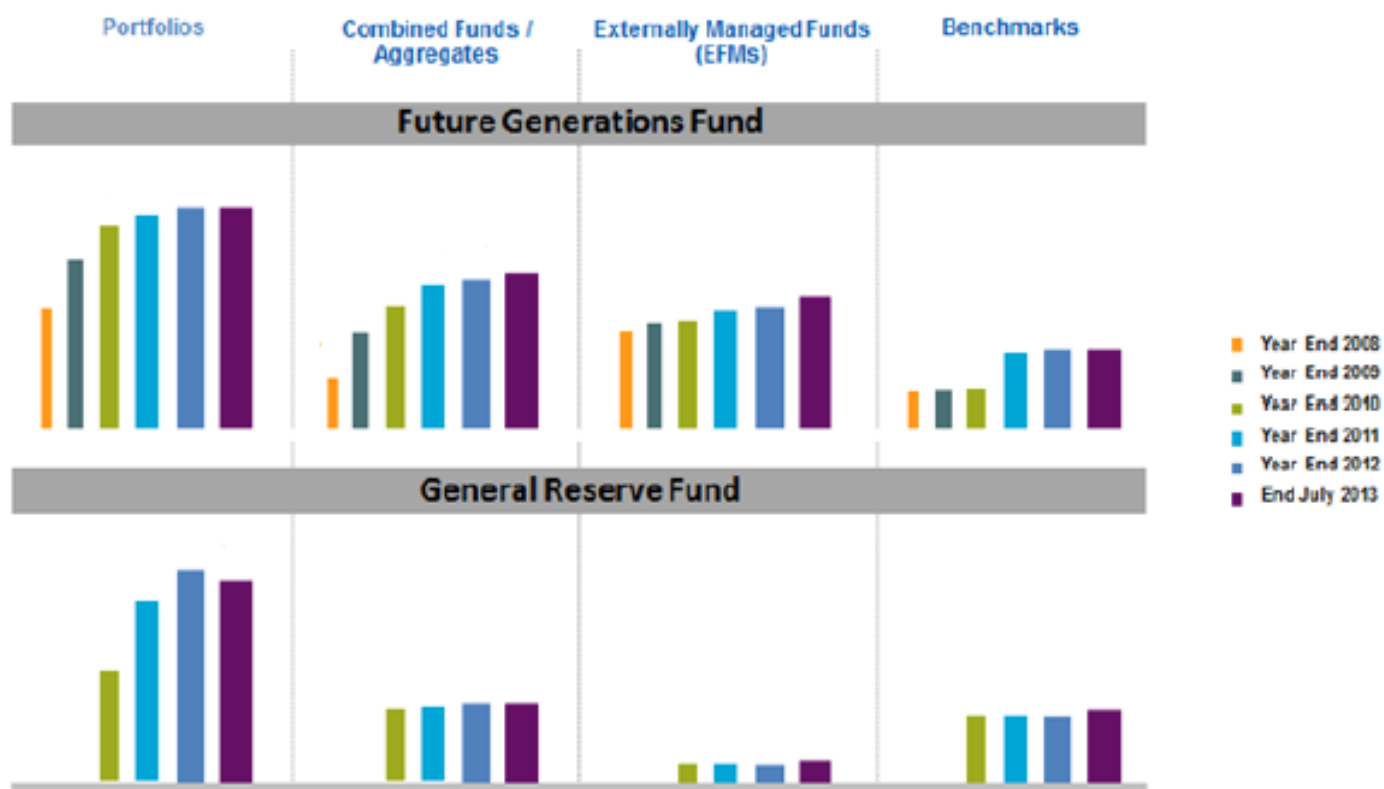
On a quarterly basis, the RPU produces a style analysis report for total FGF, which assesses the investment characteristics of the FGF by using a nine quadrant style box.



On a quarterly basis, the RPU produces an optimization report for total FGF, which assesses the risk/reward characteristics of the FGF.



Since its establishment in 2008, RPU’s output increased gradually in line with the significant growth of KIA’s assets under management. The number of portfolios and composite/combined fund structure have grown significantly as demonstrated below*:



The number of RPU reports increased from significantly since 2008. Over time, the performance and risk output has evolved to include more comprehensive and detailed analysis.

