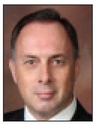
Indonesia's sovereign wealth fund version 2.0

There has been no shortage of excitement, confusion and skepticism surrounding Indonesia's announcement to establish a sovereign wealth fund (SWF) to support the country's US$429 billion-worth of priority projects and the new capital city. Government officials have indicated that the fund would be different from traditional SWFs (like Norway and Singapore) that redeploy taxpayer funds into a global portfolio of investments and securities with the aim of achieving yields above sovereign bonds. EDWARD GUSTELY writes.



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Indonesia's proposed SWF version 2.0 is a clever approach that is not without risk. It aims to raise funds from foreign investors instead of utilizing the country's reserves. Through the fund, investors will act as anchor investors or co-investors for national priority projects covering infrastructure, energy and resources, healthcare, tourism and technology. Later, the fund and its investors will be directed to finance the recycling of government-linked assets.

Much of the enthusiasm for this new version comes from officials expressing their optimism that foreign investors are keen to fund national projects including the US, Japan and the UAE. To crystallize these good intentions into actual commitments of financial, intellectual and mental capital, it is helpful to review a few lessons that were learned from Indonesia's SWF version 1.0.

Launched in 2008, SWF 1.0 was capitalized by Indonesia's Ministry of Finance (MoF) and managed by its newly established bureau, the Government Investment Unit or Pusat Investasi Pemerintah (PIP). Operating under the MoF allowed PIP to develop its investment portfolio and management capabilities while minimizing outside interference.

PIP funds were used to support national priority projects including Indonesia's infrastructure finance agencies (SMI, IIF), infrastructure guarantee funds and financing land acquisitions. PIP also anchored the country's first co-investment platforms to catalyze and channel foreign investment to support the country's low-carbon growth plan. These platforms were Indonesia's Green Investment Fund and Cleantech Fund launched during the UN Climate Change Summit (COP-15, Copenhagen).

To underwrite PIP's growth and diversify its capital pool (beyond government dependence) required a change in its legal status from a government bureau to a corporation. An extensive review of prevailing Indonesian corporate laws, governance structures and investment regulations showed that none could address the best way to ensure PIP's fit-for-purpose role and independence. With no effective solution, SWF 1.0 was eventually shelved followed by the transfer of PIP's portfolio to other state-owned enterprises.

Since then, Indonesia has become a trillion-dollar economy, achieved sovereign investment-grade status and is delivering on its infrastructure program. Building on this momentum, what are the key attributes that foreign investors will be looking for in the new SWF 2.0?

Independence and governance

SWF 2.0 would need to be established as a sui generis institution, giving it independence to carry out its mandate (like Indonesia Eximbank), and comply with prevailing Indonesian corporate laws and statutes for joint investment companies. Fund managers would be appointed by the board of commissioners and investment committee; its operations managed by the board of directors. Representation on each board would be proportional to shareholders' investment capital. The investment committee holds approval over the allocation of funding resources to support individual projects.

Funding and co-investment platforms

SWF 2.0 funding could come from IPO proceeds of state-owned enterprises, state budget reserves or issuing its own securities. Serving as the anchor investor, the fund could establish a Project Financing Platform (PFP) and Project Equity Platform (PEP). The PFP would pool institutional investors for purchasing project/infrastructure loans from qualified banks in order to free up their balance sheets for originating new such loans. The PEP would pool private investors for providing 'top-up equity' to meet project financing requirements.

Project eligibility, scale and time frame

A project would be evaluated by the consistency with the goals of the national strategy and the capacity to transform sectors onto technology pathways. Foreign investors would expect SWF 2.0 to contribute at least 10% of a US$40 billion investment pool or more to have a credible impact, with project selection beginning within six months. SWF 2.0 has the potential to become an effective platform for engaging and aligning the needs of foreign investors with the government's stated development themes, priorities and actions. It can channel these efforts away from mercantilist policies favoring short-term capital, and direct them toward building the country's industrialist credentials that require greater sums of imported, long-term capital.

The knowledge gained from these past initiatives can serve to broaden and deepen SWF 2.0's role and impact; not only in 'getting things right' through growth strategies concentrated in improving investment liquidity and generating employment, but also in 'doing the right things' with greater transparency, precision and consistency.

Alternatively, the failure to get it right would send foreign investors elsewhere and feed market doubters skeptical of Indonesia's ability to deliver on its nation-building plan using other people's money.

The stakes could not be higher.