



*cutting through complexity*

# Emerging trends in the Sovereign Wealth Fund landscape

**Middle East**  
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ADVISORY





**Vikas Papriwal**

Partner and Head of  
Sovereign Wealth Funds  
and Private Equity,  
UAE and Oman,  
vikaspapriwal@kpmg.com  
+971 4 403 0350

## Foreword

There is no doubt that SWFs in the Middle East region are continually evolving and, as part of this, becoming increasingly sophisticated in their operations and execution of their respective investment strategies. While investment objectives have certainly changed (including geographical and sector focus), diversification remains a key and common objective for Middle Eastern SWFs as countries in the region seek to reduce their reliance on energy, oil and gas prices.

Through our long term presence in the Middle East region and role in a number of the region's landmark projects, KPMG as a firm has developed a deep understanding of SWFs in the region. This publication includes a selection of thought leadership articles written by KPMG partners and SWF specialists from throughout the region and aims to provide an interesting insight into the recent trends seen in SWF investment across a number of key countries, including the United Arab Emirates, Qatar and Kuwait.

In this time of lingering economic uncertainty, the role of SWFs in the global economy has only strengthened. Based on what are now strong foundations for growth and investment, we are confident that 2013 will prove to be an extremely active and productive year for SWFs in the region.

Special thanks to the contributors and the KPMG reporting team for their support and efforts in compiling this report.

**Contributors:**

- Robert Ohrenstein
- Rajesh Menon
- Anindya Roychowdhury
- Nilesh Ashar
- Vikas Papriwal

**KPMG reporting team:**

- Brad Whittfield
- Jawad Shafique
- Zuhaib Khan



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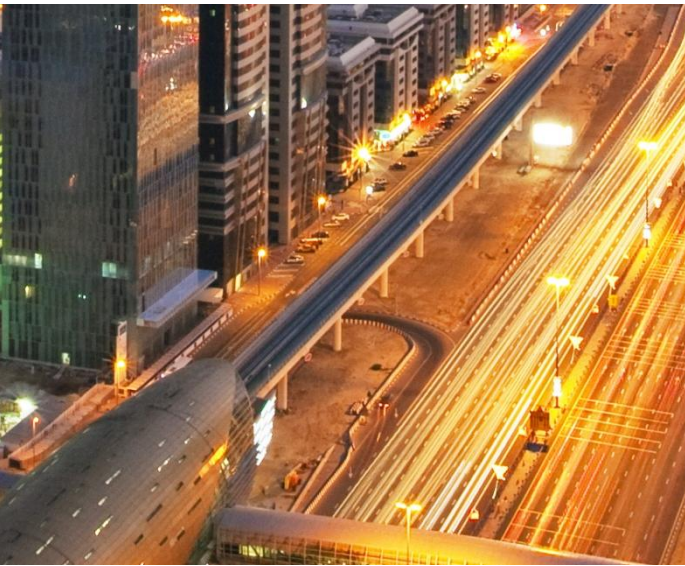
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# **An introduction to the regional SWF landscape in the Middle East**



## Overview

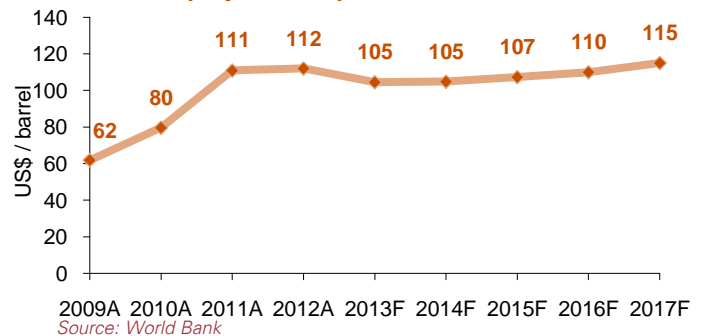
The global SWFs currently control an aggregate of approximately US\$5.3 trillion in assets under management (AUM). Of this amount, the GCC SWFs (most notably ADIA, currently the world's second largest SWF behind the Norway Government Pension Fund) account for approximately 30% of global SWFs by AUM.

Top 10 Global Sovereign Wealth Funds (AUM)			
No	Country	Sovereign Wealth Fund	AUM (US\$ billion)
1	Norway	Government Pension Fund	716
2	UAE	Abu Dhabi Investment Authority ("ADIA")	627
3	China	SAFE Investment Company	568
4	KSA	SAMA Foreign Holdings	533
5	China	China Investment Corporation	482
6	China - Hong Kong	Hong Kong Monetary Authority Investment Portfolio	299
7	Kuwait	Kuwait Investment Authority ("KIA")	296
8	Singapore	Government of Singapore Investment Corporation	248
9	Russia	National Welfare Fund	176
10	China	National Social Security Fund	161

Source: SWF Institute as at March 2013

Like the rest of the world, the Middle East was impacted by the global financial crisis which saw SWFs in the region curb their investment activity, and in many cases, reset their investment strategies altogether. While recent years will be remembered for the financial crisis, the impact on SWFs in the oil rich countries was partly mitigated by the increase in the price of oil (often trading well in excess of US\$100 per barrel since 2011). Therefore, as the economic world crawls out of the economic slowdown, these organisations appear to be in the best position to take advantage of the recovery in the global markets.

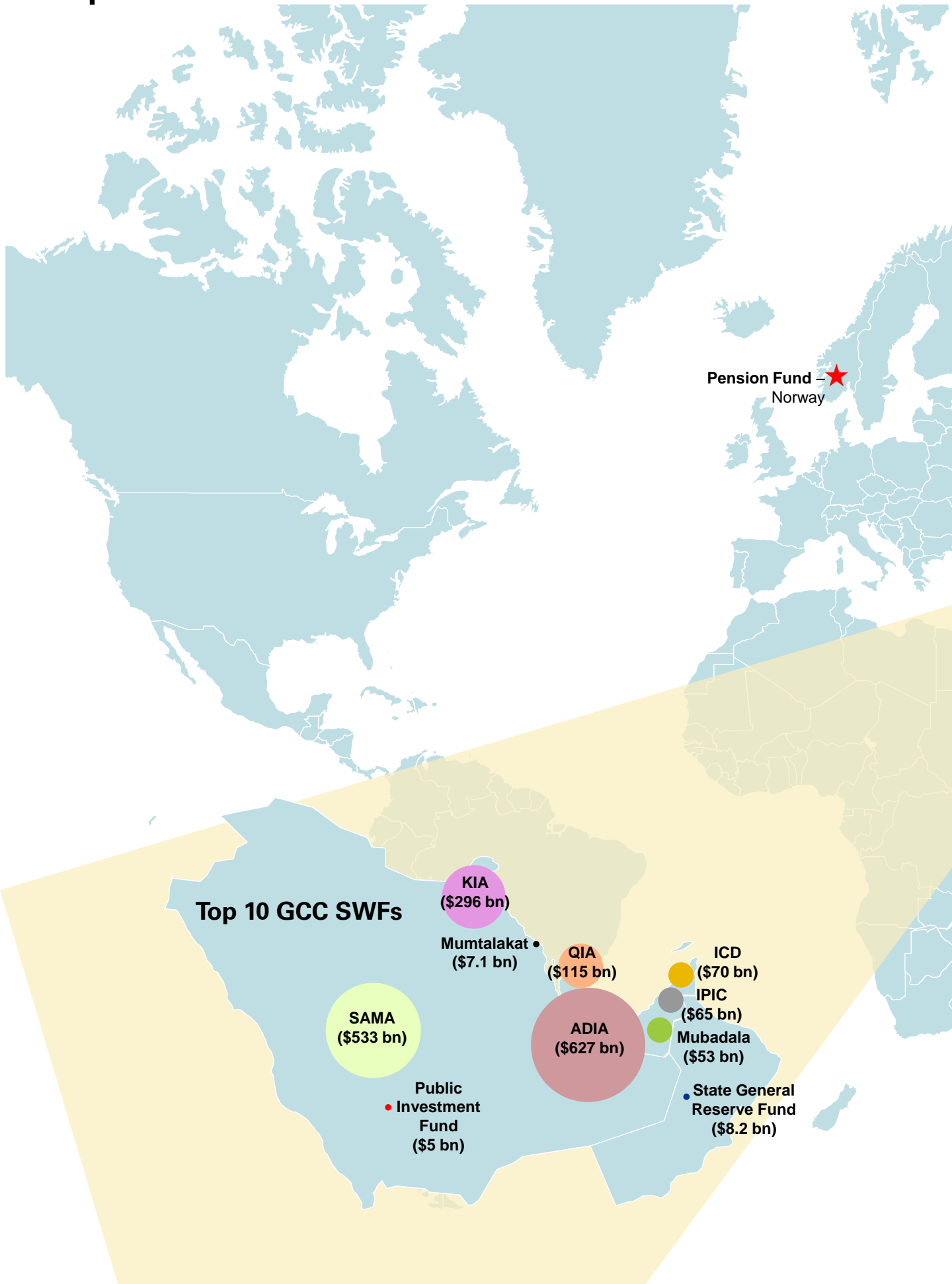
### Historical and projected oil prices



There is no doubt that, as liquidity tightened in the West thanks largely to the lingering impact of the financial crisis and, more recently, the Euro zone sovereign debt crisis, Middle Eastern SWFs' influence on the global economy has grown. Now, more than ever, these SWFs are viewed by the West as a vitally important source of capital. However, despite this fact, SWFs in the Middle East appear to be viewing the West with caution and, as a result, have invested less internationally than they have done in the past. Whether this is due to international forces, such as the Euro zone debt crisis, or as a result of local factors, such as the Arab Spring, it is becoming evident that SWFs are redirecting a portion of their funds from international investments back into the Middle East. Generally speaking, the most common changes within the region can be seen in local wage inflation and increases in major local infrastructure spend - evident in Qatar as the country gears up for the FIFA World Cup in 2022, and in Abu Dhabi as it seeks to grow into a major global financial centre and true global city (Abu Dhabi's 2030 vision).

Looking forward, 2013 is set to be an extremely active year for SWFs in the region. Many funds have increased their headcount significantly during 2011 and 2012 and have strengthened their in-house capabilities. While distressed periods are typically times when oil-rich SWFs have taken advantage of 'opportunities' to acquire trophy assets in the West, we expect there to remain a heightened sense of caution. Western governments and organisations looking for capital from the Middle East need to adapt and demonstrate a deep understanding of what is driving the thinking of SWFs in the region, and be dedicated to making a long term commitment to building relationships that add value to their investment policy.

# Top 10 Global SWFs





Source: SWF Institute – ranked by AUM at April 2013



# Global trends in sovereign investing



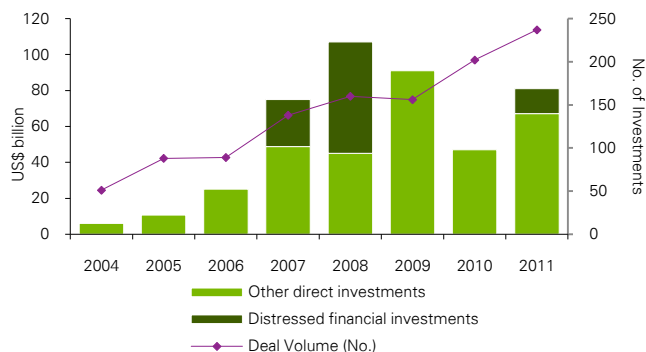
## **Robert Ohrenstein**

Global Head of Sovereign Wealth Funds and Private Equity  
London

[robert.ohrenstein@kpmg.co.uk](mailto:robert.ohrenstein@kpmg.co.uk)  
+44 (0) 20 7311 8849

Robert Ohrenstein is KPMG's Global Head of Sovereign Wealth Funds and Private Equity. Robert has extensive experience in the private equity industry, and advises several of our largest clients including Cinven, Carlyle, KKR, Permira and CVC. He has worked on a wide range of transactions, across a number of industries.





Source: Sovereign Investment Lab and KPMG analysis

Examining the data a little deeper reveals a different picture as we would argue that distressed investments made in domestic banks during the financial crisis were largely politically driven and investments in distressed global international financial institutions one-off and opportunistic in nature. Eliminating these investments from the capital deployed statistics reveals a trend line more aligned with the broad upward trend in the numbers of direct investments made.

## Introduction

There is considerable diversity within the sovereign investment fund community in terms of size, investment strategy, investment management outsourcing and operating structure. As such comparisons between funds are not always relevant and broad trends within the industry can be obscured. We thought it might be useful to explore two of the key trends we see in the industry, the move toward direct investment or other forms of investment over which more control is exercised and the upgrading of risk and control environment, and share some thoughts on where these trends may be headed in the future.

## Direct investment

We believe we are seeing an accelerating trend toward direct investment or strategies that offer the investor a greater level of control or influence over investment strategy. For the purposes of this discussion we shall define direct investment in quite a broad sense to include direct investment, co-investment alongside another investor such as a property company and investments made via structures over which the investor has a degree of discretion such as certain 'managed account' arrangements with private equity fund managers.

This may appear surprising to some and is certainly contrary, in capital terms at least, to what data providers are telling us.

We should also bear in mind that data providers have to rely on publically disclosed data that we believe only captures a small proportion of direct investments. Clearly it is impossible to speculate about the actual level of direct investment but we would think it is likely to be a multiple of the above reported numbers given the aggregate asset base of SWFs is circa five and a half trillion dollars. We therefore need to rely on more anecdotal sources of information to support this rationale.

We believe there are some themes we are seeing in the market that support this view. Firstly we are seeing a number of funds hiring investment and investment management professionals to increase their capacity to evaluate direct investment and co-investment opportunities typically in asset classes that lend themselves to direct investment such real estate and private equity (ironically the fact that these people are available is for some part down to the global financial crisis). In parallel with this we have noted some funds appearing to alter their asset allocation to provide these new resources with capital. That said it is still relatively rare to see SWFs take control positions in companies and actively manage the underlying assets outside the real estate sector and the holding of nationalised assets.

We are also seeing some patterns of investment that suggests SWFs want to manage their investment strategies more actively, and potentially increase their opportunity for direct co-investment. This is particularly noticeable in private equity with managed accounts and the investments we have seen in private equity management companies. Managed accounts, whilst not direct investment per se, do give investors a greater input into investment strategy particularly in the case of PE houses operating multiple strategies. We have also seen a number of SWFs take stakes in management companies of private equity funds. Many commentators believe a component for the rationale of these investments is a closer alignment with the PE fund allowing better access to direct co-investment opportunities alongside the private equity fund.

Looking to the future where can we expect these trends to go? Our view is that we are unlikely to see large scale adoption of the full private equity model in terms of SWFs taking control positions and participating in the management of assets. This is probably a step too far in terms complexity and we would question whether there would be large scale appetite for SWF capital on these terms. We do see further growth in direct passively managed minority investments, JVs and co-investment in infrastructure and private equity alongside existing real estate strategies. One area we might also anticipate some development may be increasing direct investment in corporate debt instruments. Given the current low yield environment in gilts, a tainted CDO market, one could see circumstances where participation in debt structures financing buyouts would be attractive. SWF investment is being sought in a new range of debt funds targeting financing of PE buyouts and it is probably not too much of a leap to bring the management of this type of investment in house especially if participating in the deal equity.

## Upgrading of risk and control environments

Many funds are relatively young organisations and many more have gone through periods of high growth and a considerable deepening in their levels of complexity as asset bases have diversified into more asset classes and these new asset classes tend to have higher levels of sophistication and complexity. Often back and middle offices and control and governance structures have not kept up with this rapid change. For some, shortfalls were exposed by the global financial crisis.

We have seen a number of SWFs starting to address these issues. Clearly different funds have different priorities but some of the issues we see being addressed include:

- Upgrading of risk management in terms of increasing the level and quality of manpower, more sophisticated systems and formalising reporting
- Re-engineering of reporting systems particularly in the area of investment monitoring
- Development of more sophisticated treasury functions
- Formalisation of the control environment and procedures
- Development or enhancement of the ESG agenda

Looking forward, work being done here is likely to leave the SWF community more robust, efficient and better able to deal with market traumas in the future.





# Qatar's large gas reserves fuelling overseas investment



## **Rajesh Menon**

Partner

Qatar

[rmenon@kpmg.com](mailto:rmenon@kpmg.com)

+974 445 76 444

Rajesh Menon is an experienced advisory partner based out of KPMG's Doha office. Rajesh heads KPMG Qatar & Bahrain's Management Consulting practice and is the Co-lead partner for Qatar Investment Authority. Rajesh has extensive experience working with Qatar Sovereign Wealth Fund entities in the areas of business planning, feasibility analysis, financial modelling, process improvement and treasury management.

## Introduction

Qatar boasts a number of impressive statistics: it has the world's highest GDP-per-capita ratio with over US\$102k in 2012; the world's third largest reserves of natural gas, just behind Russia and not far behind Iran; and it has the world's highest industrial production growth rate (27.1%). Winning the right to host the prestigious 2022 FIFA World Cup, the first Arab nation to do so, further accelerates the already rapid growth trajectory of this dynamic gulf state.

An important tool in managing Qatar's affairs is the Qatar Investment Authority ("the QIA"), the state's sovereign wealth fund. The QIA was established by Emiri decree in 2005 to manage the oil and gas surpluses of Qatar. Its prime objective is revenue diversification to minimise Qatar's reliance on energy prices and thereby securing the future prosperity of its people.

While Qatar recently signed the Santiago Principles, which outlines transparency and governance guidelines for sovereign wealth funds, detailed information is still difficult to come by. With reportedly over US\$100 billion in assets under management, it's within the top 12 largest SWF's in the world.

## The QIA's investment strategy

The QIA appears to pursue a multi-dimensional investment strategy, consisting of the following targets:

- Strategic investments used to gain stakes in multinational corporations, which provide not only access to capabilities and knowledge furthering the broad ambitions of Qatar, but also strengthen the country's exposure to key economies, supporting the brand on an international level.

- Opportunistic assets, acquired through leveraging Qatar's investible surplus and proprietary access to deals allow them to cash in on opportunistic investments.
- Trophy assets, which are primarily driven by branding and long-term benefits, rather than solely profit maximisation objectives.
- Investments with longer term horizons undertaken to strengthen inter-governmental relationships.

Through "Qatar Holding", its direct investment arm, and property investment company ("Qatari Diar"), the QIA has acquired a significant range of assets in industries such as hospitality, real estate, financial services, commodities, and retail.

Large stakes in household names in financial services such as Credit Suisse, Barclays, Agricultural Bank of China, Banco Santander Brasil, and the London Stock Exchange are as much a part of the QIA's portfolio as Volkswagen, Porsche, Tiffany, LVMH, Sainsbury's or Harrods. Other well-publicised investments include the QIA's stake in French oil major Total, Royal Dutch Shell, and BAA, the owner of London's Heathrow airport. Its real estate investments include: the historic Le Lido at the Champs Elysees in Paris; the CityCenterDC in Washington, which is believed to be the largest downtown development currently underway in any US city, and the London Olympic Village.

The opportunistic investment motive is discernible in the fund's actions related to opportunities thrown up by the financial crisis in the European Union. During the crisis period, the QIA picked up assets at attractive prices in places such as Greece, Spain, France and Germany.

The estimated US\$30 billion to US\$40 billion of investible surplus the fund has available to invest on an annual basis makes it ideally positioned to take advantage of emerging opportunities and make significant direct investments. However, as opposed to a pension fund investment process, which follows a more rigorous bottom-up investment process, the QIA is run with less bureaucracy, making it a nimble investor able to make swift decisions on direct investment opportunities when needed.

Indeed, several smart investments made depict the QIA as a highly sophisticated and strategically astute investor. This is exemplified for instance by the QIA blocking in June of 2012 Glencore's bid for Xstrata in which the SWF holds an 11.9% ownership stake. Strategic moves can also be seen in the QIA's investments in both Volkswagen and Porsche. The QIA also invested US\$150 million in the UK's venture capital fund for clean energy.

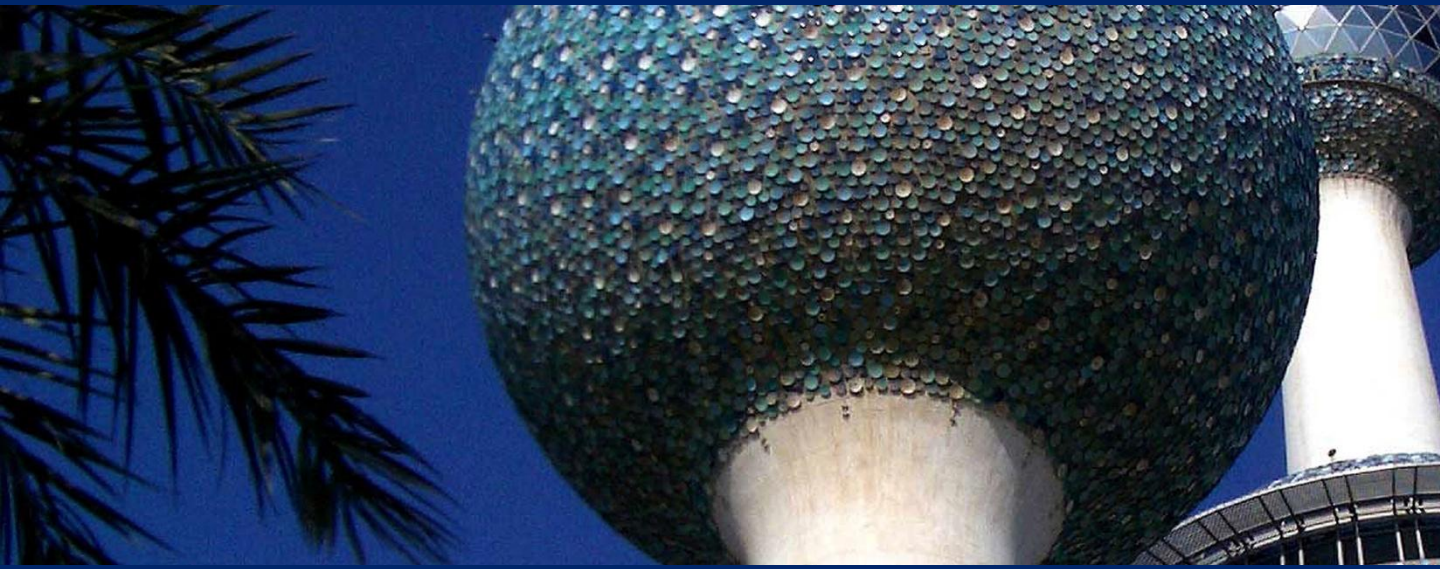
Similarly, strategic considerations related to the 2022 FIFA World Cup and the desire to advance Qatar as a footballing nation are likely drivers behind the acquisition of the prestigious Paris St. Germain football club. Along the same lines, the QIA has announced plans to diversify the Harrods brand through expansion into the hotel business. Initially targeting Paris, New York, China, and Malaysia as destinations, the expansion could likely also include Qatar itself, which after all needs to add about 50,000 hotel rooms for the 2022 FIFA World Cup.

Within Qatar's domestic economy, the QIA emerges as a cautious long-term strategic player. During 2009 and 2011, for instance, the fund injected US\$2.8 billion into the domestic banks to ensure availability of sufficient capital and has assumed a significant share of non-performing loans.

## What's next for the QIA?

The fund continues to be interested in trophy assets with long-term potential and strategic investments. The QIA has indicated an increased interest in commodities, and is for instance bolstering its investments in mineral exploration and extraction in Africa and South America. Furthermore, there are several indications supporting the conclusion that the QIA is more focused on optimising the value of its portfolio by actively exploiting synergies across its invested companies.





# The Kuwait Investment Authority

## - Supporting Kuwait's national development



### **Anindya Roychowdhury**

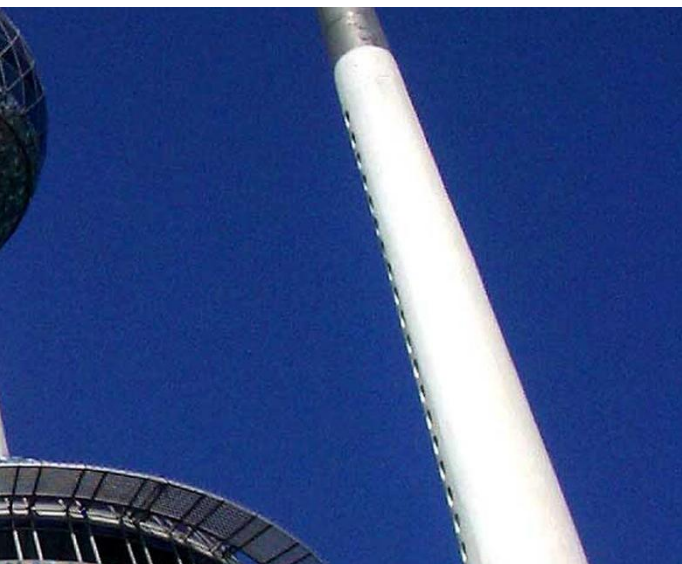
Partner

Kuwait

[anindyaroychowdhury@kpmg.com](mailto:anindyaroychowdhury@kpmg.com)

+965 224 75 090

Anindya is Partner and Head of KPMG Kuwait's Transactions & Restructuring practice. He has over 23 years of experience in financial advisory, with a specific focus on mergers & acquisitions, joint ventures, infrastructure and project financing. Anindya has advised the KIA and its subsidiaries on numerous pre-feasibility and economic impact assessments, including some high profile and mega projects.



## Introduction

The Kuwait Investment Authority (“the KIA”), established by the Kuwait Government in 1953, is the oldest sovereign wealth fund in the world. The KIA plays a stewardship role in investing Kuwait’s surplus oil revenues across local and international asset classes to diversify Kuwait’s economy away from oil and to ensure prosperity of future generations.

Befitting its status as one of the largest sovereign wealth funds in the world, with estimated assets under management of US\$296 billion, the KIA receives considerable attention for its international investment initiatives. Governments raise polite eyebrows and analysts keenly follow the KIA’s investment moves as it goes about busily acquiring and exiting stakes in prestigious companies such as BP, Citibank, Daimler, Merrill Lynch, CVC Capital and many others.

However, what is probably not as well known is the considerable influence the KIA has on Kuwait’s domestic economy and the key role it plays in supporting the Kuwait Government’s agenda of national development, often acting as the financier of last resort. The KIA achieves this through both direct investments and special-purpose portfolios.

### Strengthening Kuwait’s financial services sector

Kuwait’s financial services sector has been one of the principal beneficiaries of the KIA’s support. The KIA injected around US\$5.4 billion into Kuwait’s capital markets in 2008, to stem falling prices that led to the Kuwait Stock Exchange shedding 35% of its market capitalisation.

The KIA helped rescue the troubled Gulf Bank in 2009, shoring up the bank’s capital base by injecting over US\$420 million, and playing an active role in rebuilding management. The KIA also acquired a stake of 24% (US\$85 million) in Warba Bank, which was established by the Kuwait Government with a view to provide additional stability to the banking sector.

Kuwait-based investment firms manage special-purpose funds and portfolios established by the KIA. At the same time, the KIA also invests in financial instruments issued by these firms and is the single largest investor in many investment companies in Kuwait.

### Supporting Kuwait’s real estate sector

In the aftermath of the global financial crisis, real estate prices in Kuwait followed the international downward trend. The large-scale overcapacity in Kuwait’s commercial real estate sector further compounded these problems. In 2011, the KIA created a five year fund with a corpus of US\$3.5 billion mandated to invest in commercial real estate. The objective of this fund was to assist developers of otherwise viable projects who were struggling to find buyers due to a depressed business environment, and in the process benefiting from the low property values.

### Representing the Kuwait Government’s interests in major private entities

The KIA holds equity stakes in several prominent private sector companies in Kuwait across sectors such as financial services, telecommunications, building materials and food and beverages, facilitating the Kuwait Government to align the strategic direction of these entities with national interests.

### Promoting technological advancements in Kuwait

In 2002, the KIA established the National Technology Enterprises Company (“the NTEC”) with a capital of approximately US\$360 million.

The NTEC focuses on investments in technologies that can benefit Kuwait and the region in life sciences, energy, water, cleantech, and information and communication.

### Financing healthcare sector development

The Kuwait Government is proposing to establish the Kuwait Health Assurance Company (“KHAC”) with an estimated capital of US\$1.1 billion with a view to privatise expatriate healthcare and augment the country’s healthcare capacity through the addition of three new hospitals and 15 new clinics. The KIA will hold a stake of 26% in this project.

## Driving SME growth

The Kuwait Government has undertaken several initiatives towards the development of SMEs with a view to drive job creation, entrepreneurship, diversification, technical innovation and economic development in the country.

Towards this objective, the KIA established the Kuwait Small Projects Development Company ("KSPDC") in 1996 with a capital contribution of around US\$358 million. The KSPDC acts as a venture capitalist, providing equity capital and strategic advice during the start-up phase to Kuwaiti entrepreneurs.

The KIA further established the National Investment Fund Portfolio in 1997 with a capital of over US\$350 million. This fund seeks to provide financing and mentorship to talented young Kuwaiti nationals in establishing their own businesses.

## Catalyst for Kuwait's domestic economy

The KIA plays a critical role in driving Kuwait's national transformation, drawing upon its considerable financial strength and influence as well as access to specialised advisors. In particular, the KIA is recognised for providing the Kuwait Government with flexibility in fast-tracking projects of national significance.







# Sovereign wealth funds: tax makes a difference



## **Nilesh Ashar**

Partner, Tax  
UAE  
nashar@kpmg.com  
+971 4 403 0300

Nilesh is a tax partner and is responsible for leading the UAE firm's international and M&A tax advisory practice. Nilesh joined Arthur Andersen in India in 1995, and after the combination with E&Y, was with E&Y India until September 2005. He then relocated to London to head E&Y's Indian Tax Desk focusing on inbound and outbound tax structuring projects. Since October 2007, Nilesh has been advising private equity and sovereign wealth funds on tax structuring acquisitions across the UK and Europe.



The assets under management of SWFs globally has been steadily increasing and stood at over \$5.3 trillion at March 2013. SWFs are investing increasingly across geographies and asset classes and are considered a significant source of capital, particularly since institutional investors scaled back their investments in light of the global financial crisis.

While most SWFs enjoy special tax exemptions in their home countries by virtue of being considered a part of Government (the UAE does not impose corporate taxes except on specified activities of foreign companies), there are taxes imposed on dividends and profits / gains earned from investments / operations in other countries. Even with corporate taxes steadily reducing in most countries globally, withholding taxes, and taxes on operations and gains can vary between 5%-35% for investments outside of GCC countries (GCC countries do not tax governments and corporates of other GCC countries). With no formal mechanism of obtaining tax credit for these foreign taxes, GCC based SWFs in particular need to consider the impact of tax exemptions available in foreign countries while deciding whether or not and how to make investments in foreign countries. Where tax exemptions do not exist, other tax planning structures will need to be considered.

In this article, we discuss the concept of Sovereign Immunity from taxes available in certain countries, and related issues that are relevant for SWFs.

## Sovereign Immunity

Sovereign immunity is a judicial doctrine under international law according to which one country is immune from suit in another country. This principle also extends to imposition of taxation on foreign governments, generally in respect of their non-commercial activities.

However, in order for foreign governments to be considered sovereign immune from tax in another country, local tax laws in the investee countries must contain specific provisions to provide the exemption. Different countries have taken different approaches to granting sovereign immunity from tax. We consider below the position in key investment markets:

**US** – Section 892 exempts certain qualifying income of foreign governments from US federal taxation (foreign government for US tax purposes includes wholly owned and controlled entity of a foreign sovereign). Exempt income under Section 892 generally includes current income and capital gains from US stocks, bonds, securities and financial instruments. Not exempted however, is income that is derived from commercial activities, received from a commercially controlled entity (CCE) (determined by reference to 50% direct or indirect interest by vote or value), or derived from the disposition of an interest in a controlled commercial entity. Regulations have been proposed for exceptions for inadvertent commercial activities of a controlled entity.

This sovereign exemption is particularly important for Middle Eastern sovereign wealth funds because no Gulf Cooperation Council countries have entered into income tax treaties with the US.

**UK** – In the UK, all income and gains that are beneficially owned by the head of the state or the government of a non-UK sovereign state are generally exempt from tax under sovereign immunity rules. The sovereign immunity only applies to direct taxes, and the non-UK foreign government will continue to be liable to indirect taxes such as VAT and stamp duty / stamp duty land tax. While the guidance is not explicit as far as exemption for commercial income is concerned, Her Majesty's Revenue and Customs (HMRC) does consider both commercial and passive income to be eligible for sovereign immunity. Unlike the US, the UK does not grant sovereign immunity to an entity owned and controlled by the foreign government. For legal liability reasons, SWFs will therefore need to consider appropriate structuring through tax transparent but legally separate entities (such as certain unit trusts and limited partnerships with separate legal liability) in order to preserve sovereign immunity but also manage its legal liabilities, particularly in joint venture structures.

Sovereign status is not automatic from a UK perspective, and would need to be confirmed on application to the UK authorities. This will entail disclosing key constitutional documents and governance information to the tax authorities, which SWFs may consider as privileged information.

**France** – Under French domestic law, foreign states benefit from an exemption from French tax only on dividends, interest and capital gains on the sale of French real estate or shares in French companies. Not eligible to exemption are royalties, commercial income, or rental income from French real estate. Taxes on such income

may be relieved under applicable double tax agreements. There are also conditions relating to seeking prior ruling from the French Ministry of Finance to obtain the exemption where foreign government controls a French company by virtue of the investment.

**Germany** – Germany does not provide for any tax exemptions to foreign governments (or entities controlled by foreign governments) under its domestic tax rules. As such, any German sourced income earned by foreign governments from investment or commercial activities are subject to German corporate tax. However, subject to conditions, a foreign government may be eligible to exemption or relief under German domestic rules or double tax treaties, as may apply to German corporations or other qualifying entities eligible to treaty relief. Where domestic tax rules do not provide for specific exemption, sometimes double tax treaties may provide for exemption or a reduced rate of taxation to certain types of income earned by a foreign government from the source country. As double tax treaties are bilateral agreements between two countries, these terms are generally agreed as part of the treaty negotiation process between the two foreign governments on a reciprocity basis. Any SWF investing in a country that does not provide for sovereign immunity must therefore seek appropriate tax advice to evaluate whether there are planning opportunities or reliefs available under tax treaties.

To summarise, SWFs must consider the specific domestic tax rules to evaluate whether their income from investments or activities in the relevant country will be eligible to sovereign immunity, and the approvals that may be necessary in order to avail such exemptions. They may also need to provide detailed disclosure of their charter documents and governance structures to the foreign government's tax authorities in order to be granted the approvals. SWFs will need to consider this aspect in light of confidentiality issues.

Where sovereign immunity exemption from taxes are available, the investments do become more tax efficient, and may even allow SWFs to bid for assets with more attractive pricing, given the comparative benefit of more attractive post tax returns, as compared to a private equity or non-sovereign investor.

Where sovereign immunity is not available SWFs need to consider tax planning structures and identify / commit resources to managing tax compliance functions. Some SWFs either have or are considering building formal tax teams that will sit with their legal or finance functions and will monitor tax issues and structuring relating to investments made by SWFs.

In an era of increasing scrutiny on tax structures, SWFs given their status, in particular need to assess their tax status and structures to ensure that any exemptions and planning is carried out in accordance with domestic law and internationally accepted tax structures and practices.

### Summary of Sovereign Immunity rules in key countries

Country	Sovereign immunity available	Active / Passive income	Available for controlled entities	Comments
US	Yes	Passive	Yes	No exemption available for commercial activities, income received from CCE or income from sale of shares / interest in a CCE. However, exemptions proposed for inadvertent breach.
UK	Yes	Passive certainly. Commercial income arguably also covered.	No	Approval required from HMRC confirming sovereign status.
France	Yes	Dividends, interest, capital gains; not eligible to exemption are royalties, commercial income or rental income from real estate.	Generally not available.	French Ministry of Finance approval required where foreign government controls a French entity by virtue of investment.
Germany	No	N/A	N/A	Tax treaty relief may be possible.



# GCC SWFs – an increasingly local investment outlook



## **Vikas Papriwal**

Partner and Head of Sovereign Wealth Funds and Private Equity,  
UAE and Oman

[vikaspapriwal@kpmg.com](mailto:vikaspapriwal@kpmg.com)

+971 4 403 0350

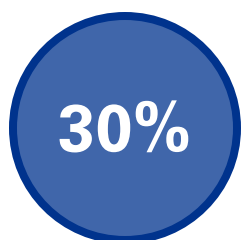
Vikas is a KPMG partner and is the KPMG country head of Sovereign Wealth Funds and Private Equity in the UAE. After making Partner as part of the Private Equity Group in London in 2008 joined the UAE practice in 2009.

During his time in the Middle East, Vikas has developed a deep understanding of the regional market. Vikas has significant experience in advising global Sovereign Wealth Funds and Private Equity firms in the region on a variety of strategic and business matters, most notably on the restructuring of Dubai World.



## Introduction

With over 10 funds and close to US\$1.7 trillion worth of assets under management, the GCC is home to the highest concentration of global SWFs. With an aim to diversify, benefit from international investment opportunities and maintain balanced investment portfolios, GCC SWFs have historically been willing to invest internationally and across a wide range of industries and asset classes. Through a number of high profile, yet economically motivated investments into the West and Asia, GCC SWFs made headlines and gained prominence as serious investors on the world stage.

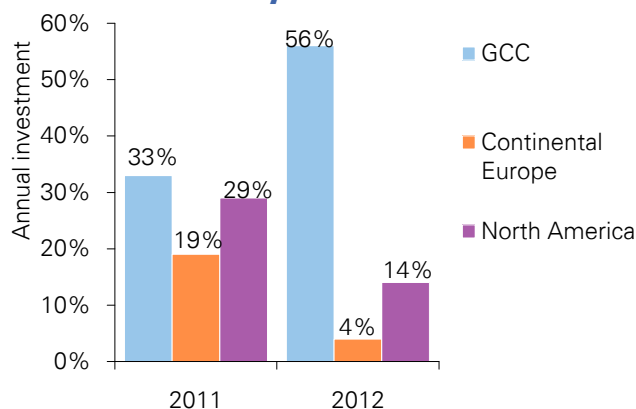


**GCC SWFs represent c.30% of global SWF funds**

*Source: SWF Institute*

To some extent, the global financial crisis did little to slow the pace of GCC SWF investments. In fact, since the beginning of the financial crisis, GCC funds continued to invest outside the region and played a key role in the global investment landscape. However, more recently, an increasing appetite to invest in local economies has become a feature of this region's SWF landscape. Global SWF investment statistics suggest a near 70% increase in GCC focused investments by regional SWFs. Therefore, the question then arises; what has driven this apparent shift in the SWF investment paradigm?

## Geographic allocation of investments by GCC SWFs



*Source: Invesco Middle East Asset Management Study 2012*

## Regional mega-development projects

The GCC region plans to spend approximately US\$142 billion on infrastructure projects between 2013 and 2020, the majority of which relates to rail and road projects. This is in addition to planned mega projects in the region such as the US\$86 billion King Abdullah Economic City in KSA, Qatar's US\$70 billion 2022 FIFA World cup related infrastructure and the UAE's US\$20 billion Masdar City development.

GCC SWFs have historically demonstrated keen interest in infrastructure and real estate investments. The proportion of infrastructure/real estate related assets under management of GCC SWFs is likely to increase as GCC governments redirect a greater portion of their sovereign wealth to SWFs with local development objectives.

Invesco's Middle East Asset Management study for 2012 suggests that the value of assets allocated to those SWFs which are investing locally (including into infrastructure) have risen by 10% from 2011. In contrast, despite a near 30% increase in the revenues of GCC economies, assets allocated to SWFs that invest primarily outside the region has fallen by 1%. It is anticipated that this apparent redirection of sovereign wealth will source a stable flow of funds into the region's infrastructure aspirations and will facilitate growth and development of the local economies over the medium term.

## Increased public spending

In stark contrast to other parts of the world where governments are promoting austerity and introducing significant cuts to public spending, high oil prices have enabled GCC governments to increase public expenditure. A number of GCC governments including those of Bahrain, Qatar and KSA have introduced considerable public stimulus programmes during the past 18 months. With a seemingly renewed focus on unemployment, education, and healthcare, regional governments are making considerable efforts to invest and promote development within their own countries.

Consequently, sovereign wealth that may have otherwise been used to fund investments outside the region, is being invested back into local economies.

## The Euro zone crisis

Continental Europe has always been a popular investment destination for cash rich GCC SWFs. From iconic car brands, to prestige real estate, top of the league football clubs, and financial institutions, Europe has historically seen a number of its most precious assets on the radar of ambitious GCC SWFs. While the Euro zone's own sovereign debt crisis has not completely halted Middle Eastern interest, GCC SWFs are becoming increasingly selective and cautious in their assessment of the continent's offerings.

A number of GCC SWFs are adopting a 'wait and see' approach to Europe as a considerable level of uncertainty continues to exist. Higher growth markets (including local economies) are gradually taking priority as reduced confidence and decreased performance from existing European portfolios has meant that GCC SWFs are less inclined to invest.

## So what can we expect from GCC SWFs from here on in?

As the shift towards local investments appears to be gathering momentum, the question remains whether this nascent position is a transitory trend or a strategic direction for the long term. While SWFs in the GCC are unlikely to become vehicles of regional investment only, it is probable that international economics will continue to drive the allocation of their funds towards local economies.

The question as to whether GCC economies are able to absorb large sovereign fund investments while providing SWFs with a suitable risk/return profile is an entirely separate matter. However, regardless of how GCC SWF investment strategies evolve, one thing is for sure: their billions of dollars of investable cash reserves will continue to ensure that they remain a key interest to the global investment community.



The background of the page features a dark, semi-transparent overlay of financial market data. It includes various numerical values in different colors (white, yellow, red, green) and line graphs with dashed and solid lines. Some visible numbers include 5197.72, 5082.42, 4967.12, Avg5=5846.47, Avg10=4976.91, 4160.03, 4044.73, 7808698, 6246958, 46857, and 31. A grey arrow points downwards on the left side of the page.

# Appendix

## **Appendix: sources of information**

- AME Info
- Arab Times
- Arabian Business
- Bloomberg
- EU GCC Chamber Forum
- Financial Times
- Invesco Middle East Management Study 2012
- Kuwait Asset Management Company
- Kuwait Investment Authority
- Qatar Investment Authority
- Sovereign Investment Lab
- Sovereign Wealth Fund Institute
- World Bank

## KPMG's SWF contacts:

### **Robert Ohrenstein**

Global Head of SWFs and PE  
UK  
robert.ohrenstein@kpmg.co.uk  
+44 20 73118849

### **Vikas Papriwal**

Lower Gulf Head of SWFs and PE  
UAE and Oman  
vikaspapriwal@kpmg.com  
+ 971 4 403 0350

### **Rajesh Menon**

Partner  
Qatar  
remenon@kpmg.com  
+974 44576444

### **Nilesh Ashar**

Partner  
UAE and Oman  
nashar@kpmg.com  
+971 4 424 8900

### **Anindya Roychowdhury**

Partner  
Kuwait  
anindyaroychowdhury@kpmg.com  
+96 522 475 090

### **Brad Whittfield**

Associate Director  
UAE and Oman  
bwhittfield@kpmg.com  
+971 4 403 0350



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