



COOK ISLANDS
SOVEREIGN WEALTH
FUND

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1 FOREWORD

Kia Orana,

A Sovereign Wealth Fund has been considered in the Cook Islands for some time, and the Cook Islands Economic Development Strategy 2030 has the creation of a Sovereign Wealth Fund (SWF) as an action. When a SWF was first considered in the early 2010's, the main focus for it was to create a place to invest the funds that may be produced by seabed mineral harvesting to ensure the wealth generated is shared across generations.

However, since the COVID-19 pandemic, and the significant impact the pandemic had on the Cook Islands, it has been clear that access to emergency funds without needing to go to foreign lenders is an important area to develop. Whether it is an emergency like we experienced with COVID-19 or a natural disaster like cyclones, adding to our country's resilience is an important development as the Cook Islands continues to grow as a nation.

The Government of the Cook Islands is aware of SWFs that have been set up in the Pacific and around and have been great successes, as well as examples that have not achieved the goals expected of them. We are looking to learn from these experiences, with a focus on promoting good governance, transparency, and accountability.

The primary objective of this Policy is to ensure that the sovereign wealth fund is best set up to meet the needs of all Cook Islanders, not only of today, but those of the future. I am grateful to all stakeholders who have engaged in the public consultation on the development of this policy in the interests of achieving our common goals.

Kia Manuia,

Hon. Mark Brown
Prime Minister and Minister of Finance



2 INTRODUCTION

The development of the Cook Islands Sovereign Wealth Fund (SWF) has been planned since the early 2010's. With the upcoming potential for extra income from seabed minerals harvesting, the Cook Islands Government intends to develop a SWF to ensure that the proceeds are shared across all Cook Islanders, today and in the future.

Seabed mineral harvesting revenue is an asset for all Cook Islanders – now and in the future, and it would not be fair if only those around when revenues come in benefit from it. Therefore, it is proposed that the SWF be developed to share the wealth from seabed mineral harvesting across time, or intergenerationally.

This policy outlines a set of key policy decisions for the Cook Islands Sovereign Wealth Fund:

- a clear legal framework that defines the objectives, institutional arrangements, and relationships with the government and other parts of the public service
- a clearly defined and publicly disclosed investment objective, and documented risk management policies
- the provision of timely and accurate information to the public and relevant stakeholders about governance, structure, financial position, and investment activities
- the creation of robust risk management frameworks to identify, assess, and manage risks in investment activities
- a desire to be accountable to stakeholders, including the government, parliament, and the public, and mechanisms for reporting and oversight

3 SOVEREIGN WEALTH FUNDS

WHAT ARE THEY AND WHY ARE THEY USED?

A Sovereign Wealth Fund is a state-owned investment fund that is set up by a country's government to invest and manage its national savings. Sources of funding for SWFs are generally revenues from resource activities (such as minerals extraction or fisheries) and non-resource activities such as development partner contributions.

In the case of the Cook Islands, potential revenue streams include development partner contributions, environmental and overfishing fines, transfers from the government budget and revenue from seabed mineral harvesting. The aim of the SWF is to preserve and grow wealth for future generations, ensure disaster response readiness and provide stabilisation in times of economic downturn.

3.1 A SWF IS AN IMPORTANT TOOL FOR A RESILIENT COOK ISLANDS ECONOMY

A SWF can be crucial for economic development, financial stability, and risk mitigation. It can provide for significant capital investment in infrastructure, education and technology, thereby encouraging long-term growth. For the Cook Islands, a SWF could fund domestic infrastructure and improve transport and communication networks.

SWFs can help to diversify the economy and reduce dependency on a single revenue source like we have here in the Cook Islands with tourism. It can also act as a stabilisation fund, buffering the economy against revenue volatility. A SWF can provide emergency funds during crises such as pandemics or natural disasters, reducing the government's need to take on additional debt. For example, during the COVID-19 pandemic, initially a mechanism similar to a SWF was used (a stabilisation fund that had been built up following a surge in government revenues from tourism), and helped to support businesses, maintained employment, and invested in healthcare in the early stages of the pandemic.

In the event of cyclones, the Disaster Response Trust Fund is currently set up but having it as an account under the SWF will allow for the allocation of a percentage of revenue into that account, growing it to a sufficient size over time. Overall, a SWF would enhance the resilience and sustainability of the Cook Islands economy, securing a more sustainable future for the Cook Islands.

3.2 SOVEREIGN WEALTH FUNDS ARE USED INTERNATIONALLY

There are many examples from around the world where countries have created SWFs. In this section we outline a few notable examples. In 1990, Norway established the Government Pension Fund Global (GPF) with a clear purpose: to manage the surplus wealth generated by the nation's petroleum income. Over the years, the GPF has grown to become one of the largest SWFs in the world, boasting assets exceeding US\$1.5 trillion^[1]. Managed by Norges Bank Investment Management, which is part of the Norwegian Central Bank, the fund employs a diversified investment strategy. Its investments span global equities, fixed income, and real estate, all aimed at achieving the highest possible return with moderate risk.

Similarly, in 1976, Alaska established the Alaska Permanent Fund (APF) to prudently invest a portion of the state's oil revenues for the benefit of current and future generations of Alaskans. With assets surpassing US\$70 billion (approximately 100% of Alaskan Gross State Product (GSP)), the APF is managed by the Alaska Permanent Fund Corporation (APFC), an independent state-owned corporation. The fund's diversified portfolio includes domestic and international stocks, bonds, real estate, and alternative assets. Notably, it is renowned for the annual Permanent Fund Dividend (PFD), which distributes a portion of the fund's earnings in the form of small annual payments to Alaska residents.

Closer to the Cook Islands, New Zealand's Superannuation Fund (NZ Superfund) was established in 2001 with the objective of assisting the government in covering the rising costs of superannuation entitlements as the population ages. With approximately NZ\$60 billion in assets (approximately 15% of New Zealand GDP), the NZ Super Fund is managed by the Guardians of New Zealand Superannuation, a crown entity. The fund's long-term investment horizon is marked by a diversified portfolio that includes global equities, fixed income, private equity, infrastructure, and real estate, with a particular focus on sustainable and responsible investment.

In the Pacific, Kiribati set up the Revenue Equalization Reserve Fund (RERF) in 1956. Its mission is to manage and invest the revenues from phosphate mining, thereby providing long-term financial stability and supporting the country's budgetary needs. The RERF, which has grown to approximately AU\$1 billion in assets (over 200% of Kiribati GDP), is overseen by the government of Kiribati. Investment decisions are guided by external advisors to ensure prudent management of assets. The fund's diversified investment portfolio focuses on generating steady income while preserving capital, with investments in global equities, fixed income securities, and other low-risk assets to ensure sustainable growth and financial stability. The returns gained from investments are used to support the national budget, invest in development projects, and environmental and climate change initiatives and adaptations given its susceptibility to climatic events.

3.3 SWFS THAT HAVE GONE BEFORE CAN PROVIDE GUIDANCE IN SETTING UP THE COOK ISLANDS ONE

Global SWFs provide a wealth of insight into best practice and potential pit falls. Here are some key takeaways, both positive and negative, from global SWF's:

3.3.1 SWF SUCCESSES

There are a number of common themes that the successful SWFs have shown, and we will ensure that these themes are reflected in the design of the Cook Islands SWF.

- Long-term investment horizon: SWFs like Norway's GPF have shown that long term investment horizons allow for better management of market volatility and the potential to earn higher returns overtime.

[1] As of June 13, the value is approximately US\$1.663 trillion, or 320% of Norwegian GDP - <https://www.nbim.no/>

- Diversification of investments to spread risk and achieve more stable returns: The Alaska Permanent Fund diversifies across global equities, bonds, real estate, and alternative assets to minimize risk and maximize returns. Many SWFs do not invest in their own countries, reducing risk of downturns affecting both the country economy and the assets of the SWF.
- Governance and Transparency: Having strong governance structures and a high level of transparency to build trust and enhance the reputation of the fund's management. E.g., the NZ Superfund is a strong example for its clear governance framework and transparent reporting by the Guardians of New Zealand Superannuation.
- Sustainable and Responsible Investment: Incorporating ESG considerations to guide investment decisions helps to manage sustainability risks.

3.3.2 NOT ALL SWF'S HAVE BEEN SUCCESSFUL

By contrast, there have been some unsuccessful SWFs, the lessons from these funds are equally as important to consider in the design of the Cook Islands SWF:

- Volatility in revenues: dependency on volatile revenue sources like natural resources or tourism can lead to unpredictable inflows (e.g., very low visitor arrivals and tourism revenue) causing economic instability, therefore effective management and diversification of revenue sources are crucial.
- Political interference: political interference in fund management can lead to poor investment decisions which can undermine the funds objectives. It is essential that the SWF operates independently and with a clear mandate.

A further role played by SWFs, especially with regard to mineral resources is mitigating some inflationary pressures. In a small economy like the Cook Islands, we are susceptible to inflationary pressures. A sudden influx of foreign money from potential seabed harvesting revenue would increase the domestic price level, causing a negative economic impact known as the 'Dutch Disease' whereby prices within the country rise too high due to the resource boom (usually due to currency appreciation, but this is less a factor for the Cook Islands), thus leading to a decline in other sectors like manufacturing and exports. It is for that reason that prudent fiscal policies are established well in advance.

Consideration of the valuable insights and challenges encountered by other SWF's will allow the Cook Islands to draw from their experiences and mitigate some of the potential risks.

3.4 THE SANTIAGO PRINCIPLES FOR SWF GOVERNANCE

The Santiago Principles^[2] are a best-practice guide to SWFs, and were developed by a group of international sovereign wealth funds, the International Monetary Fund (IMF) and the Organization for Economic Co-operation and Development (OECD) in 2008. This group was formed because there were some concerns raised about a lack of transparency and accountability in how sovereign wealth funds operated. SWFs were growing in importance in the world economy and there was a desire to create a set of principles and best practices to guide the governance and operations of SWFs.

The principles were designed to address key areas for SWFs, including transparency, accountability, governance, and responsible investment practices. They have been developed to learn from previous SWF experiences around the world. The establishment of these principles, aimed to promote greater confidence in SWFs among recipient countries, financial markets, and the public, and to encourage SWFs to adopt best practices in their operations. The principles were not legally binding, but acted as a set of guidelines and best practices that SWFs could voluntarily adopt. Since 2008 many SWFs have endorsed and implemented the Santiago Principles.

[2] As of June 13, the value is approximately US\$1.663 trillion, or 320% of Norwegian GDP - <https://www.nbim.no/>

The Cook Islands will use the Santiago Principles as a base in the design of the Cook Islands Sovereign Wealth Fund, in the interests of transparency, accountability and undertaking responsible investment practices. For more detail of the Santiago Principles and how they apply to the Cook Islands Sovereign Wealth Fund, please see “A guide to the Santiago Principles”, available on the MFEM website.

3.5 WHY DOES THE COOK ISLANDS WANT A SWF?

The principle of intergenerational wealth spreading, also known as intergenerational equity, refers to the concept of ensuring that the benefits of a country's wealth are distributed fairly over different generations. For the Cook Islands, we recognize the importance of our 'Akapapa'anga, which aligns with this principle well – to look after different generations, and maintain the links between our people. The principle of intergenerational equity recognizes that natural resources and other forms of wealth are finite and should be managed in a way that benefits both the current generation and future generations.

It is about ensuring that the benefits of a country's wealth are shared fairly among different generations, with a focus on preserving wealth for the long-term benefit of society. It would be profoundly unfair to other generations to spend wealth that comes from Cook Islands' resources only on today's generation when those resources belong to all Cook Islanders, both those of today and those of the future.

We have been taking small steps down this path for some time, with many key national documents and legislation have signaled the establishment of the Cook Islands Sovereign Wealth Fund. These include:

NSDA 2020+ Pledge 11:

The NSDA 2020+ discusses the role played by a SWF in the long-term prosperity of the Cook Islands, with Pledge 11 (To Tatou Kimi'anga Puapinga – Our prosperity) declaring: “In a time of prosperity our nation will manage public money with integrity and transparency. Sovereign wealth funds may be created and will be utilized towards the wellbeing and resilience of our nation.” The concept of Akapapa'anga is the cornerstone of the NSDA 2020+, and this aligns with the creation of a SWF.

Cook Islands Economic Development Strategy 2030:

The EDS 2030 discusses management of a stable macroeconomic setting in particular “establishing reserve funds (Stabilisation Account and Sovereign Wealth Fund) to save excess revenues for periods of economic downturn of natural disasters, and for future generations...”

The EDS 2030 also commits the Government to undertaking the necessary policy and legislative work to establish a SWF. This is the work that is being undertaken with this policy document.

The Seabed Minerals Act 2019:

Section 100 of the SMA 2019 references a Sovereign Wealth Fund, and states that any royalties and all revenue other than trading revenue (for example, license fees) paid to the Crown or to the Authority under section 98 must be collected separately.

4 A SWF MUST HAVE CLEAR OBJECTIVES

4.1 WHAT DOES THE SWF HOPE TO ACHIEVE, WHAT IS ITS PURPOSE?

A Sovereign Wealth Fund should have a clear purpose to guide how it is funded, managed, and used. A SWF is a tool for economic stability and growth and is distinct and separate from other public finance mechanisms. The SWF's purpose sets short, medium, and long-term goals, explaining how the fund's earnings (returns on investments) will benefit the nation. For the Cook Islands, the government currently saves money through the Medium-Term Fiscal Strategy (MTFS) and the budget process. Funds like the Disaster Response Trust Fund and the Stabilisation Account play a crucial role during crises, managing economic fluctuations and ensuring financial stability, and are built up slowly over time.

In the long-term, the SWF aims to save extra revenue for future generations. These savings will generate investment returns that will be used to improve public services such as health and education, as well as infrastructure, which in turn will boost economic growth.

There are three main objectives for the Cook Islands SWF:



A SWF needs a clear overarching governance structure that includes its management and administration. This ensures it is run effectively and in the best interests of the country, with regular reporting and transparency. as the funds are held on behalf of the Cook Islands' people. The main components of this organizational structure (and their roles) are:

1. **Governing Board** - Oversees the overall direction and management of the SWF, ensuring that policies and strategies align with the fund's goals
2. **Trustee and/or Custodian Bank** - Responsible for holding and safeguarding the SWF's assets, ensuring their security and proper management
3. **Investment Advisor and Fund Manager** - Provide expert guidance and manage the SWFs investment portfolio to achieve the desired the financial outcomes
4. **SWF Administrator** - Handle the day-to-day operations and administration of the SWF, implement board decisions and policies
5. **Independent Auditor** - The independent auditor conducts regular audits to ensure the SWF's financial integrity, transparency and accountability

Around the world, SWFs have different structures but broadly similar roles and responsibilities. The crucial factors are the SWF's relationship to governments, its respective independence, and the resources available to either manage investments in-house or with external advisors. There is significant diversity in how SWFs around the world choose to operate within these roles and responsibilities. This draft policy, and the public consultation process will determine the most appropriate structure for the Cook Islands.

The objective is to find the right mix that provides an efficient management and administration structure and functions to suit the respective country's needs and interests. These include providing accountability, efficient investment management, effective investment performance, and transparency at a reasonable cost.

5 LEGAL AND INSTITUTIONAL FRAMEWORKS WILL DEFINE HOW THE SWF OPERATES

5.1 THE SWF WILL BE AN INDEPENDENT LEGAL ENTITY?

The Cook Islands SWF should be an independent entity registered in the Cook Islands according to Cook Islands law, such as an independent authority or non-profit organization. The SWF should be a legal body with the ability to:

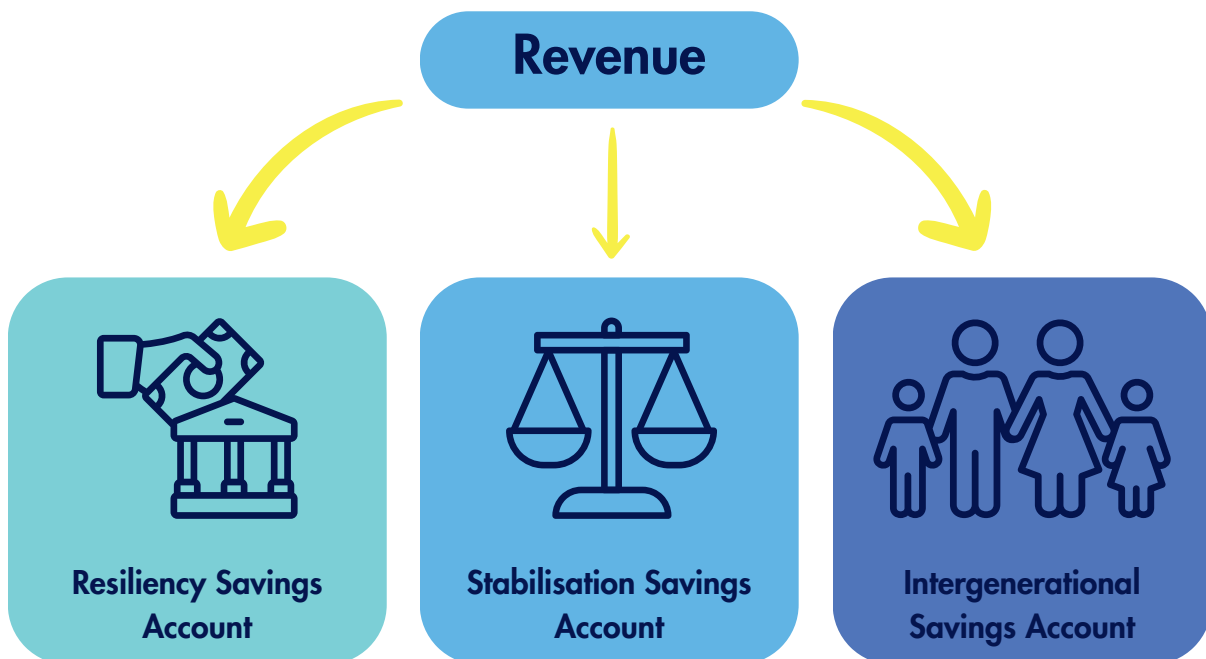
- contract,
- acquire and dispose of immovable and movable property,
- institute legal proceedings, and take other actions to protect the Fund

By being an independent entity, the Cook Islands SWF will be able to operate without concern for interference and will know it will have stable governance structures and freedom of decision making in order to buy and sell assets.

5.2 STRUCTURE AND GOVERNANCE OF THE SWF

The SWF will be divided into 3 main accounts: a Resiliency Savings Account for disaster preparedness and response, a Stabilisation Savings Account to maintain economic stability, and an Intergenerational Savings Account for long term savings benefiting future generations. Each account would receive a portion of the identified revenue^[3] to build up reserves and ensure a stable fiscal environment for the Cook Islands.

Additionally, there will be a fourth account: Distribution Holding Account – This account would hold the funds agreed to be distributed by the board until the funds are transferred to the government. This account would have a subaccount for each of the four distribution areas.



The SWF would be governed by a Board. The Board will ensure that the Fund is maintained in accordance with its Act. The Board will have the following functions:

- a) the operation, supervision, and management of the Fund; and
- b) the investment and distribution of resources of the Fund

[3] The Resiliency Savings Account and Stabilisation Savings Account would both have caps on the total value, above which all eligible revenue would go to the Intergenerational Savings Account

In practice, many of these functions would be contracted to expert advisors, but ultimate responsibility rests with the Board.

The Board will be constituted with ten members – seven voting members and two observers. In addition to the identified Board members, the SWF will also reserve a position for an international financial institution, either as a voting member or as an observer. The preferred international financial institution is the Reserve Bank of New Zealand, however other regional or global institutions could be considered such as the Asian Development Bank or the World Bank. The appointments would be rolling, fixed terms to include a mix representing Cook Islands citizens and professionals with practical finance expertise. The Board should consider gender and aim to achieve gender diversity. And, the representation of all age groups should be considered, including youth above the age of 25 years old.

The board will consist of the following:

Voting Members

- Financial Secretary, Ministry of Finance and Economic Management (Chair, for the term as Financial Secretary),
- 3x Professional Members with Finance expertise – (3 years each, appointed via an independent process),
- House of Ariki (self-nominated, 3 years)
- Religious Advisory Council (self-nominated, 3 Years)
- Cook Islands Professional Body (Banking Association and Legal Society rotating appointments between the two entities every 2 years)

Observers

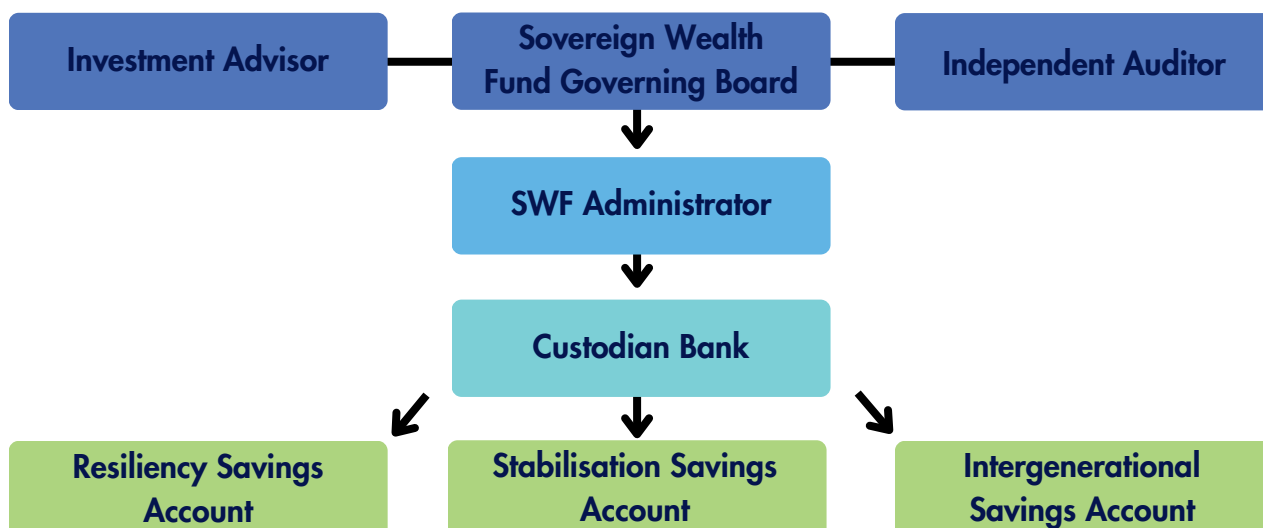
- Pa Enua Representative (3 years, appointed by the Prime Minister)
- Civil Society Representative (3 years appointed by the Cook Islands Civil Society Organization)

Ex Officio

- Reserve Bank of New Zealand

The purpose of the breakdown is for the Board to have cross representation from the Cook Islands and strengthen its independence so it can focus on its assigned functions. The members also bring different aspects of capabilities to have a more rounded technical background for the Board as a whole. There will be an emphasis on financial expertise, including investment expertise, regarding the three Finance professional members and, to the extent possible, for the Cook Islands Professional Body representative so the Board has at least four members with practical finance experience. Members will also be subject to a fit and proper person test before being appointed to the Board. It is highly recommended that the Reserve Bank of New Zealand be consulted on a regular basis to provide expertise and help with the application of international standards and practices. Members will serve for a maximum of two terms.

The diagram below illustrates the operational structure for the Cook Islands Sovereign Wealth Fund.



5.3 A SWF MUST BE TRANSPARENT AND ACCOUNTABLE TO THE PEOPLE OF THE COOK ISLANDS

Since a SWF represents a portion of the country's wealth set aside to generate revenue for a financial safety net and wealth for future generations, accountability and transparency is crucial. Although the funds are held in trust by an entity, the true owners are the people of the Cook Islands.

Therefore, it is essential to inform the public regularly about the SWF's status, with provisions in place to ensure it is managed and administered according to industry standards and principles. For example: adopting the Santiago Principles will oblige the Cook Islands SWF to adhere to strict transparency obligations and this will be reflected in the Fund's reports and if the Cook Islands are to subscribe to the International Forum of Sovereign Wealth Funds (IFSWF), there are expectations for transparency that are expected from members.

The first step towards accountability is ensuring that the Board and everyone involved with the SWF, including service providers, have a fiduciary responsibility. Fiduciary responsibility means acting in good faith, with trust, confidence, and honesty, always in the best interest of the people of the Cook Islands. For an investment fund, principles of loyalty and care ensure public trust in those managing the fund.

Strict processes and rules governing the Cook Islands SWF made adherence to core fiduciary principles practical and reliable, fostering a culture of responsibility. Fiduciary excellence relies on how well the Board, custodian/trustee, investment advisor, fund managers and SWF administrator staff follow best practices. Even when duties are delegated, stewards must oversee professionals to ensure responsibilities are carried out carefully and responsibly.

Further, the investment policy for a SWF includes specific restrictions: no investments within the Cook Islands and not allowing the SWF to access debt. If it is designed as a perpetual fund for future generations, accessing the principal is prohibited, with the Board ensuring these rules are followed.

Other SWF's create by-laws based on their enabling act, conflict of interest and confidentiality statements for members and staff, and adopt management principles like NGPFG. Annual reports, audits, and external evaluations ensure accountability and transparency, aligning with international standards.

To keep stakeholders informed, SWFs adopt methods such as user-friendly websites, press releases on meetings, publishing annual and audit reports and public outreach meetings. These efforts keep the public informed about the SWFs activities and investment performance. The Cook Islands SWF will follow these transparency principles.

5.4 A SWF MUST BE REGULARLY AUDITED

A key part of the transparency and accountability of a SWF is a regular, independent audit. In the case of the Cook Islands SWF, the requirement will be that an independent audit is conducted each financial year, and is published within six months of the end of the financial year. This audit is to be conducted by an independent auditor, to ensure there is no scope for any potential conflicts of interest or undue influence.

This requirement ensures that the SWF, as a mechanism for the savings of the Cook Islands people, is transparent, and the performance is readily accountable. Having an independent auditor also avoids any possible perception of influence on the reports.



6 FUNDING OF THE SWF

How a SWF is funded is crucial to the success of the SWF, as it shapes what contributions can be made. The investments of the SWF are derived from the contributions, and from the Investments is where the returns and distributions come from. Funding sources may include natural resource revenues, environmental fines, and contributions from development partners. Unlike other public finance mechanisms, a SWF serves as a tool for economic stability and growth. Its purpose should establish short, medium, and long-term goals, outlining how the fund's earnings (returns on investments) will benefit the nation.

In the Cook Islands, the government currently saves funds through the Medium-Term Fiscal Strategy (MTFS) and the budget process. Funds such as the Disaster Response Trust Fund and the Stabilisation Account play a crucial role during crises, managing economic fluctuations, and ensuring financial stability, and these funds are contributed to through the budget process.

There are various potential revenue streams that the Cook Islands may utilize to fund its SWF. These are discussed in the next section.

6.1 EXAMPLES OF SWF FUNDING SOURCES

A number of funds such as the Timor-Leste Petroleum Fund, Trinidad and Tobago's Heritage and Stabilisation Fund, and Norway's GPF are funded by revenue from natural resource income. In contrast, there are some mixed funding models like the Tuvalu Trust Fund, which incorporates both natural resource revenue and development partner contributions. Another model is where budget savings and grants form the basis of trust funds for the Federated States of Micronesia and the Marshall Islands, primarily through U.S. government grants, while grants and service-related payments fund Nauru's Intergenerational Trust Fund through development partner contributions.

6.2 COOK ISLANDS SWF WILL BE DESIGNED FOR MIXED FUNDING

The fund is likely to be primarily funded by seabed mineral harvesting revenue, should that eventuate, with potential development partner contributions, transfers from the annual budget for disaster preparedness, fiscal stabilisation, other government revenues (particularly one-off revenues). Identified revenues will go into the SWF, allowing it to accumulate, with returns on the fund ultimately being able to be disbursed – see Section 9 on distributions.

For some context, the next section discusses the existing Disaster Response Trust Fund and Stabilisation Account, and how they are proposed to fit within the SWF.

- **Disaster Response Trust Fund**

The Disaster Response Fund was established for quick disaster response. Currently the fund sits at NZ\$2.1 million, with expected annual contributions of NZD \$50,000 from the general budget. The establishment of this fund was detailed in the Cook Islands Disaster Response Trust Fund Policy, approved in cabinet in May 2011. The purpose is to enable a swift and coordinated response by the Disaster Response Executive once a state of emergency is activated or disaster declared. A share of eligible revenues is planned to go to a successor version of this Fund (the Resiliency Savings Account) under the SWF, until a sufficient cap of 8% of GDP is reached.

- **Stabilisation Account**

The account, initially part of the general reserve, was set up independently in the 2019-20 Budget with NZ\$56.7 million allocated for economic downturns. The account was designed to hold cash in excess to general operation needs and working capital. Its intent was to provide resources for economic support and stimulus during periods of economic contraction, defined as growth of less than 1% per year. The account was drawn down in 2020-21

because of the COVID-19 pandemic's negative economic impact. Currently, NZ\$3.5 million remains in the account and is not expected to increase over the medium term unless there is a significant upturn in tourism. Similarly, to the Disaster Response Trust Fund, a successor version of this Fund is planned to exist under the SWF, accumulating reserves to a specified cap.

6.3 HOW WILL THE SWF OPERATING COSTS BE PAID FOR?

Operation costs for the SWF will include:

- **Board member fees:** These fees will be minimal and in keeping with both the overarching goal of the SWF, and accepted Cook Islands practice.
- **SWF administrator:** The Board will direct the Custodian Bank, in writing, to pay any fees and expenses of the SWF Administrator staff and contractors as approved by the Board, from the Fund assets, in accordance with agreed contractual obligations.
- **Auditor Fees:** The Board will advise the Custodian Bank to pay the fees and expenses of such an Auditor from the assets of the Fund.
- **Investment Advisor and Fund Managers:** The Board will direct the Custodian Bank, in writing, to pay any fees and expenses of the Investment Advisor(s) and Fund Manager(s) as approved by the Board, from the Fund assets, in accordance with formerly agreed contractual obligations. The fees should be part of the competitive bidding process and any fees should be negotiated by the Board during contract negotiations.
- **Custodian Bank Fees:** The Custodian Bank would be paid reasonable fees and expenses from the Fund for the provision of the services as Custodian Bank. Such fees and expenses shall be subject to the prior written approval by the Board. The fees should be part of the competitive bidding process and any fees should be negotiated by the Board during contract negotiations.

In the early years of operation of the fund, the fees to run the full SWF may exceed the returns received from the fund's investments, particularly when the fund is very small. In that case, there may be a transitional arrangement where a lower fee, simplified investment regime is undertaken until a full SWF structure is created. There would be a trigger point (in relation to fund value compared to a share of Cook Islands GDP) that would signify a transition to a fully operational SWF structure. There may also be some merit in Government appropriating some funding for SWF operations in this initial period to allow the SWF to be established.



7 INVESTMENT STRATEGY

The Cook Islands SWF will invest the funds received. The idea behind funds' investments is that over the long term, investment returns are likely to be larger than the rate of inflation. The higher the return above inflation is what allows the fund to grow over time, and for the fund to be able to pay out as well. If the funds are not invested, then the value of the funds will be eaten away by inflation and would reduce in real value.

Determining how the funds are invested needs an investment policy. This policy sets out rules about how a fund can invest its money. These rules give the SWF Board and the SWF Investment Advisor a clear focus on how the funds can be invested as well as direction on what returns the fund might expect to make over a medium- and long-term investment horizon. The investment rules will also give guidance about what risk might be acceptable.

The SWF's enabling legislation should note that the Board will create and update an investment policy every year. This policy should be made with the help of certified investment professionals, like the Fund's Investment Advisor. For smaller SWF's, it is more efficient for the Investment Advisor to prepare the policy and have the Board review and approve it. Once approved by the board, it should be monitored with help from the Investment Advisor and the SWF administrator, and reviewed externally every five years.

The Investment Policy is set out with the following key parts:

- **Introduction Purpose of the SWF** – A restatement of the purpose of the SWF, as stated in its establishment act, and any other objectives the Board wants to achieve. An introductory section briefly describes the purpose of the Investment Policy Statement.
- **Responsible Parties and Fiduciary Duties** – Indicates the roles and responsibilities of the main parties to include the Board, Investment Adviser, Trustee and/or Custodian, and other service providers. It also describes who has a fiduciary duty to the SWF.
- **Investment Objectives, Beliefs and Asset Allocation** – Indicates the overall investment objectives in terms of return objective, timeframe and risk parameters. It may differentiate between short, medium and long-term timeframes. The investment beliefs are statements that give guidelines on how the funds should be invested. The risk components are identified to provide guidelines on some of the limits to investment so return objectives can be clarified.
- **ESG Statement – Investment Objectives, Beliefs and Asset Allocation** – Identifies the SWF's investing interest around environmental, social and governance factors. This is tailored to the Board's interests as well as interests of the Cook Islands government and public, as reflected by the Board. The Board may want to have public consultations with the public to gauge ESG interests as they evolve over time.
- **Performance Standards** – Identifies the SWF's benchmarks. The benchmarks should be industry standard benchmarks that are objective and are applied to the entire portfolio, asset categories^[4], and individual investment funds. The asset allocation will be reported against these benchmarks on a monthly, quarterly and annual basis as well as over historical time periods (1, 3, 5, 10 years and since inception, for example).
- **Investment Guidelines and Restrictions** - Identifies any specific guidelines or restrictions such as investment in active and/or passive funds, exposure to developed and emerging markets, grade of fixed income investments allowed, statement on diversification, and other investments that may/may not be allowed.
- **Evaluation and Review** – Identifies who does the review, review and possible termination of Investment Adviser and Fund Managers, and review of the overall investment program.
- **Conflict of Interest Policy and Related Party Transactions** – States guidelines to prevent conflicts of interest and states disclosure requirements.

7.1 ASSET ALLOCATION WILL DRIVE INVESTMENT RETURNS AND RISK

The asset allocation is deciding how to divide investments among different types of assets. This is important because it reflects the fund's goals for growth and how much risk it is willing to take. At the beginning of a Sovereign Wealth Fund (SWF), investments are often placed in safer options like money market funds, term

[4] Such as total public equity (possibly broken down to developed market equity, emerging market equity), fixed income (broken down to the various fixed income categories), and alternative assets (broken down into alternative asset categories such as hedge funds, private equity, public or private real estate funds, etc.). The investments must be securities issued or recognized in any major stock exchange agreed to by the Board, or other instruments issued by certified Fund Managers.

deposits, and mutual funds until the fund is fully operational and the Board is knowledgeable and experienced enough to oversee more complex investments. These sophisticated investments are usually added gradually as the fund grows. For example, when the Norwegian Government Pension Fund Global began, initially it could only invest in government bonds, and after time a capped number of equities (like shares) were allowed, and eventually real estate.

All SWF investment decisions should be made with advice from a certified investment adviser or other licensed professionals.

As an example, the Intergenerational Trust fund for the People of the Republic of Nauru has a 4-stage investment program designed at its start-up in 2015 and a planned 20-year build-up period:

- **Stage 1 - years 0-3 (completed):** The objective of stage 1 is to build the capital base of the fund by investing within a diversified investment option with an allocation of 70-75% to growth assets.
- **Stage 2 - years 4-15 (current):** The objective will be to increase the allocation to growth assets through a more bespoke asset allocation to increase the real return potential of the fund.
- **Stage 3 - years 16-20:** The fund will gradually reduce the allocation to growth assets as it approaches maturity. Sufficient liquidity will be required as the Fund prepares for distributions to begin.
- **Stage 4 - years 20 and beyond:** Consistent with stage 3, a significant portion of the fund will be retained in growth assets with ongoing review to ensure sufficient liquidity to enable annual distributions of earnings.

For the Cook Islands' initial asset allocation, since it is unknown at this time when and how much in seabed mineral revenues will be contributed to the SWF, a staged investment plan should be considered. When the SWF is first established, it will at least have funds contributed to the Account 1 Resiliency Savings Account and Account 2 Stabilisation Account. The plan can consist of the following general approach. A more detailed approach should be determined with the advice of a qualified professional investment firm before investments are made.

***Stage 1:** After contracting a Custodian bank, invest in a mix of term deposits and government fixed income instruments that are sufficiently liquid if needed.*

***Stage 2:** Once the SWF reaches NZ\$25 million, invest in a mix of passive global diversified index funds (by country, region, international) and fixed income instruments (public and private).*

***Stage 3:** Once the SWF reaches NZ\$50 million obtain professional advice for investments in Stage 2 investments (active and passive public equity and fixed income funds) plus alternative investments (hedge funds, real estate funds, private equity, etc.). All investments should be qualified instruments as previously defined.*

7.2 RISK PROFILE

Risk can mean how much investment returns can change over time. A higher risk investment could mean that investments can go up by more but also could go down by more. In the long run, higher risk can mean higher returns, but a fund would then have to accept that there will be some years when the funds' investments could reduce in value. Alternatively, a lower risk investment strategy would see fewer years where the fund's investments go down, but in the long-term the funds returns could be lower than a higher risk strategy.

7.3 GEOGRAPHICAL RESTRICTIONS - WHERE SHOULD A SWF INVEST?

A SWF typically avoids investing within its own economy for several valid reasons:

- Investing locally could distort the local banking and investment sector creating disincentives for other banking and investment services and vehicles and crowd out domestic and foreign investment and may result in the SWF becoming a lender of first or last resort.
- If large sums are contributed to infrastructure development, the local construction and maintenance work could lead to increased local competitive issues, cause price-push inflation, and a possible influx of foreign contractors.
- The board and Administration will not have the expertise to determine investable projects, if a project is “bankable” then it should be left for the local, regional, or international financial institutions or local and/or foreign private investors. The Board and administration will also not have the expertise or resources for such investment project management.
- To maintain an arm’s-length relationship to government so there is no political influence on investments
- Country governments usually want their SWFs to be an alternative funding source to provide short, medium, and/or long-term financial budget support that is not dependent on in-country economic performance and diversifies the country’s public finance resource base and economic resource base.

In the Cook Islands situation, a SWF may be used to protect against natural disasters like cyclones, so having investments that are also exposed to cyclones would not be a good idea – as when they are needed most, their value will be least. A small country like the Cook Islands might also face significant inflation risks if the SWF were to invest locally, as well as risking the local banking system and investment system being distorted.

The purpose of a SWF is also to create an independent source of funds that is not tied to the local economy and helps to diversify the Cook Islands revenue; for example, if the SWF were to invest in a tourism venture and there was a tourism downturn, then the country’s tax take would go down, as well as the SWF facing lower returns or even losses from the tourism investment.

For these reasons, the Cook Islands Sovereign Wealth Fund will not be permitted to invest domestically.

7.4 RISK MANAGEMENT

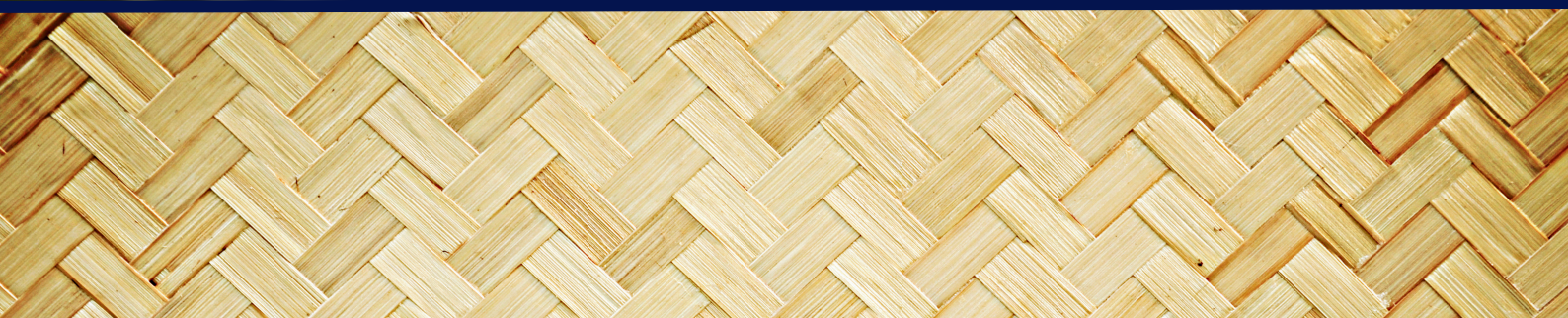
In either legislation or the investment policy statement, there should be clear statements about investment limitations. Areas to be covered include:

- **Investments in qualified instruments.** A qualified instrument is defined as stocks, bonds, and other securities issued or recognized in any major stock exchange agreed to by the Board based on Investment Adviser advice, or other instruments issued by certified Fund Managers and approved by the Board, in accordance with the Investment Policy, and based on Investment Adviser advice. Speculative investments, such as crypto currency, should be prohibited since they are not listed on major investment exchanges and add a different set of risks including reputational risk.
- **Investments within country.** As covered previously in section 7.3.
- **Not creating access to the base of the fund for disbursements.** As the SWF goal is to provide for intergenerational returns for all Cook Islands, using the base of the fund to pay for expenses now would mean the fund would no longer grow, and would likely be used up instead of remaining a store of wealth.
- **Not using the SWF to issue claims against the funds’ assets or to create a debt against the fund or fund contributions or fund returns.** That is, not allowing the fund to take on debt. This is very risky, and could threaten the entire fund or stop investments being made.

7.5 ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CONSIDERATIONS

ESG investing aims to identify and invest in companies that are both financially sound and operate in sustainable and socially responsible manner. The Cook Islands can gain valuable insights into investment considerations by looking at the ESG practices adopted by other SWFs. The Norwegian Government Pension Fund Global (NGPFG) is internationally recognized for its proactive ESG approach to investments, which the Cook Islands may find beneficial to incorporate into its SWF investment strategy. Placing an emphasis on robust governance and ethical standards, establishing ethical investment guidelines, and prioritizing long-term sustainability are important aspects to consider. Moreover, engaging with relevant stakeholders to enhance ESG practices can facilitate regular reviews in response to climate change and social development.

The investment policy statement for the Cook Islands SWF will have an ESG statement identifying the SWF's investment interest per environmental, social and governance considerations. This will provide direction on asset allocation and particular investment fund selection. Further, the board may want to have public consultations with the public to gauge ESG interest as they evolve over-time.



8 DISTRIBUTIONS

A key part of how a SWFs operates is how the fund distributes its returns for the benefit of Cook Islanders. The distribution policy explains the approach and method for how funds can be spent. Having set rules for distributions will guide the Board of the SWF on what the goal is/what to do, but also promotes accountability and transparency of the SWF to the public.

Santiago Principle #4 emphasizes the need for SWFs to have clear and publicly disclosed policies regarding their funding, withdrawal, and spending. An example of compliance with Principle #4 is the Alaska Permanent Fund (APF), based on petroleum and mining resources. In 2018, the APF adopted a Percent Of Market Value (POMV) spending policy to ensure sustainable annual draws.

The four key principles for the APF's approach are:

1. Adherence to rules-based formulas: rules-based formulas for fund transfers to ensure sustainable draws and predictable outflows.
2. Ensuring Sustainability: preserving purchasing power of the fund to generate a sustainable income for future generations.
3. Inflation proofing: Guaranteeing annual transfers to protect against inflation, ensuring these transfers are automatic rather than discretionary.
4. Promoting real growth: investing in opportunities to grow the Fund's value, including reinvesting excess returns and saving surplus revenues from oil and gas.

The Cook Islands SWF will also have key principles for ensuring sustainable annual distributions from the SWF, and propose basing the Cook Islands principles on those set out by the APF. More detail on this is discussed below.

8.1 HOW LONG DOES THE FUND BUILD FOR?

To allow the Intergenerational Savings Account to build-up to a reasonable value, the account will adopt an either/or approach to ensure that distributions are not locked away forever:

- Distributions from the Intergenerational Savings Account will be available when the Fund ends its build-up period after 20 years or when the Intergenerational Savings Account's net asset value reaches 50% of Fiscal Year 2024-25 Gross Domestic Product plus an agreed cumulative inflation adjustment.

Putting this into perspective: a trigger of 50% of forecast 2024-25 Cook Islands GDP would be approximately \$315 million. Based on a likely return percentage of 3% above inflation, that would imply an annual distribution from the fund in the region of \$9 to \$10 million per year.

8.2 HOW MUCH OF THE FUNDS CAN BE SPENT?

As noted, before, there are three sub funds that make up the Cook Islands SWF:

1. Resiliency Savings Fund, for disaster response and mitigation and preparedness
2. Stabilisation Savings Account, for developing cash reserves
3. Intergenerational Savings Account, for medium- and long-term intergenerational savings
4. Distribution Holding Account, to hold funds allocated to the four different expenditure areas

Distributions from the Intergenerational Savings Account will be used only to support the following areas:

- Healthcare;
- Infrastructure;
- Education (including culture); and
- Environmental concerns.

These particular areas have been chosen because these are areas that build the nations' capital stock and by directing returns to these areas, improve social stability, reduce future liabilities and promote long-term economic growth. By using the distributions from the SWF in these areas, steps can be taken to improve the future prospects for all Cook Islanders.

8.3 MAINTENANCE OF CAPITAL BASE & SMOOTHING OF RETURNS OVER TIME

How much to be distributed from the fund's earnings must be defined in advance. Without clear rules, there is a significant risk that the funds value is not maintained, and eventually would be drawn down to nothing. The intention is for that not to happen, so distributions will be set following a specific rule.

That specific rule will be a certain distribution percentage of the fund value which will be determine using the following formula:

$$\text{Transfer amount} = \text{distribution \%} \times \text{moving average}$$

The fund value would be a moving average of the last five years of the funds value to smooth out any changes in the fund value from investment returns. The distribution percentage reflects the projected long-run earnings of the fund (again to smooth out any high or low years of returns) minus prudent allowances for expenses of the fund, minus an allowance for inflation (to protect the real value of the fund) and minus a small sustainability allowance of 1% (to allow for a small continued growth in the value of the fund).

$$\text{Distribution \%} = I - C - \pi - SA$$

Where:

I = Long – run projected returns

C = Prudent expenses of the SWF

π = Allowance for inflation

SA = Sustainability Allowance

For example, if the long-run projected return of the fund were 7.5%, the expenses of the fund were 0.2% of the value of the fund, inflation was 2.5%, then the distribution allowance would be given by:

$$\text{Distribution \%} = 7.5\% - 0.2\% - 2.5\% - 1.0\%$$

$$\text{Distribution \%} = 3.8\%$$

This rule takes inspiration from the Norwegian example, where a '3% rule' is used. That is, no more than 3% of the return can be transferred to the national budget – as the long-term real rate of return is estimated at approximately 3%.

The fund distribution percentage would be able to be varied over time by the Board, provided that the distribution percentage maintains the real value of the fund, and that it reflects the returns experienced by the fund.

8.4 ACCESS TO EMERGENCY FUNDS

The resiliency savings fund and the stabilisation savings account will be distributed on a 'needs' requirement following the meeting of specific triggers – such as the declaration of a natural disaster or similar.

- Disaster Response

The Resiliency Distribution would be available for disbursement in the case of a disaster, and would occur within three days of a request from the Financial Secretary of the Ministry of Finance and Economic Management

- Stabilisation Savings

The stabilisation distribution would be in the case of a significant economic contraction, with increasing portions of the fund released (within 14 days). In order to access it, MFEM would need to define how the amounts would be used, over what time period, and how the proposed spending would be monitored.

All funds made available under these terms would need to be accounted for and reported on transparently – including being subject to standard Government audit practices.



9 SWF RISKS & MITIGATIONS

Sovereign wealth funds (SWFs) are government-owned investment funds that manage a country's reserves to achieve long-term economic and financial objectives. For the Cook Islands, a nation with limited resources and a heavy reliance on tourism to drive the economy, establishing and managing a SWF entails various risks and requires strategic mitigations to ensure macroeconomic stability.

9.1 MACROECONOMIC STABILITY

The Cook Islands SWF faces several risks and challenges due to the nature of its funding sources and economic environment. Revenues are likely to come from seabed mineral harvesting, environmental and overfishing fines, government budget surpluses or development partner contributions. With seabed mineral harvesting and tourism both being volatile industries, this can lead to economic instability, as the country's small, open economy is particularly vulnerable to external shocks. Heavy investments in international markets could amplify these risks, making the economy even more susceptible to global economic fluctuations.

To mitigate these risks, the SWF should focus on diversification, spreading its investments across various asset classes and geographic regions. Establishing a stabilisation fund within the SWF can also provide a financial cushion during downturns, helping to buffer the economy against revenue shocks.

Additionally, the SWF faces challenges related to balance of payments, and inflation. One significant risk is the so-called 'Dutch Disease', where a surge in natural resource revenues makes other sectors less competitive. To combat this, phased investment of the SWF's inflows can help manage the pace of capital inflows and mitigate the risk of Dutch Disease and inflation.

Inflation poses a significant concern when there are substantial and abrupt influxes of foreign capital, which can augment the domestic money supply and provoke inflationary tendencies. Economic distortions and inflation, often referred to as the "resource curse", may arise from an excessive dependence on resource revenues. To deal with these problems, it is crucial to uphold strict management rules and only withdraw from the Fund during periods prevailing macroeconomic conditions.

For the Cook Islands, establishing a sovereign wealth fund can provide long-term economic benefits, but if not managed properly, it poses significant risks to macroeconomic stability, the balance of payments, and inflation. By implementing strategic mitigations such as diversification, phased investments, support for non-resource sectors, and prudent fiscal and monetary policies, the Cook Islands can effectively manage these risks and harness the potential of its SWF to foster sustainable economic growth.





Our land is not ours to own, we're just
caretakers of it for the next generation

- *Albert Henry*