

Fund Profile: Kuwait Investment Authority (KIA) (1 of 3)

December 2011

Snapshot:

Name:	Kuwait Investment Authority	Source of funds:	10% of state oil revenues / investment proceeds
Country:	Kuwait	Investment returns:	8.5% annualized (20 years, 1991 – 2011)
Established:	1953	Office locations:	Kuwait City, London, Beijing
Total Assets:	US\$290 billion (est. 2011)	Legal Structure:	Separate legal entity, accountable to parliament
Ownership:	Ministry of Finance of Kuwait	Key Sectors:	Real estate, banking, insurance
Fund type:	Future generation fund ¹		

History and Purpose:

Founded in 1953, the Kuwait Investment Authority is the oldest Sovereign Wealth Fund in the world. In 1982, the Kuwait Investment Authority (KIA) was established to assume the responsibility of managing Kuwait's state assets. The KIA manages two funds: the General Reserve Fund (GRF) and the Future Generations Fund (FGF). The GRF is the main treasurer for the government. It receives all state revenues (including oil and gas) and all national expenditures are paid out of this fund. The GRF also holds all government assets, including the Kuwait Petroleum Corporation and Kuwait's involvement in multilateral organizations such as the IMF, World Bank, and Arab Fund. The FGF was created in 1976 through a transfer of 50% of the GRF's assets. It's initial mandate was to invest in assets outside Kuwait. By law, 10% of state revenues are transferred to the FGF annually. The KIA may also manage other funds entrusted to it by the Minister of Finance. The KIA is an asset manager, and does not own any of its assets.

Current Holdings (Estimated)²

1. Daimler AG (6.9% / \$5B)
2. BP Plc (~2% / \$2.8B)
3. Bank of America / Merrill Lynch
4. TPG (~2.5% / \$250M)
5. Citic Securities Hong Kong
6. Arab Insurance Group (12.4% / \$127M)
7. Gulf Bank (16% / \$800M)
8. Jordan Phosphate Mines Co. (9.3%)

Recent Divestitures:

1. Citigroup (4.9% / \$3B, sold for \$4.1B / 37% return)

Investment Strategy:

Since 2004, based on the advice of a consultant, the KIA has re-shaped its strategy according to the following principles:

1 Actively manage fund managers

Historically, KIA was seen as an "easy" client. Since 2005, KIA has terminated or withdrawn \$48B in assets and made \$108B in additions and new appointments. Last year, 64% of managers outperformed their index, adding 12 basis points to returns.

2 Diversify risk and smooth earnings

KIA has pushed into non-correlated assets, such as emerging economies and non-traditional asset classes, such as PE, real estate, and hedge funds. Alternatives have grown from 13% to 27% of KIA's portfolio since 2004 (see chart to right).

3 Increase risk appetite

In search of higher returns, KIA has expanded the range of fixed income options to include emerging market and high yield bonds, and relaxed its minimum rating criteria from AA to BBB- for corporate and sovereign debt.

4 Bet on high growth economies

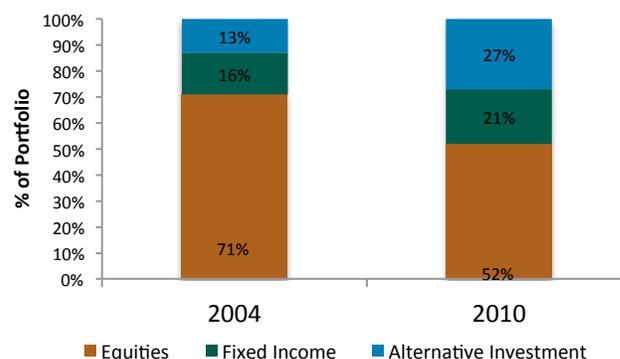
KIA has increased its investment in mainland China from zero to \$5.6B since 2005 and recently opened an office in Beijing. The Board has called for increased investment in Eastern Europe, Australia, Russia, and throughout Asia.

Breakdown of Investments:

Geographic Diversification

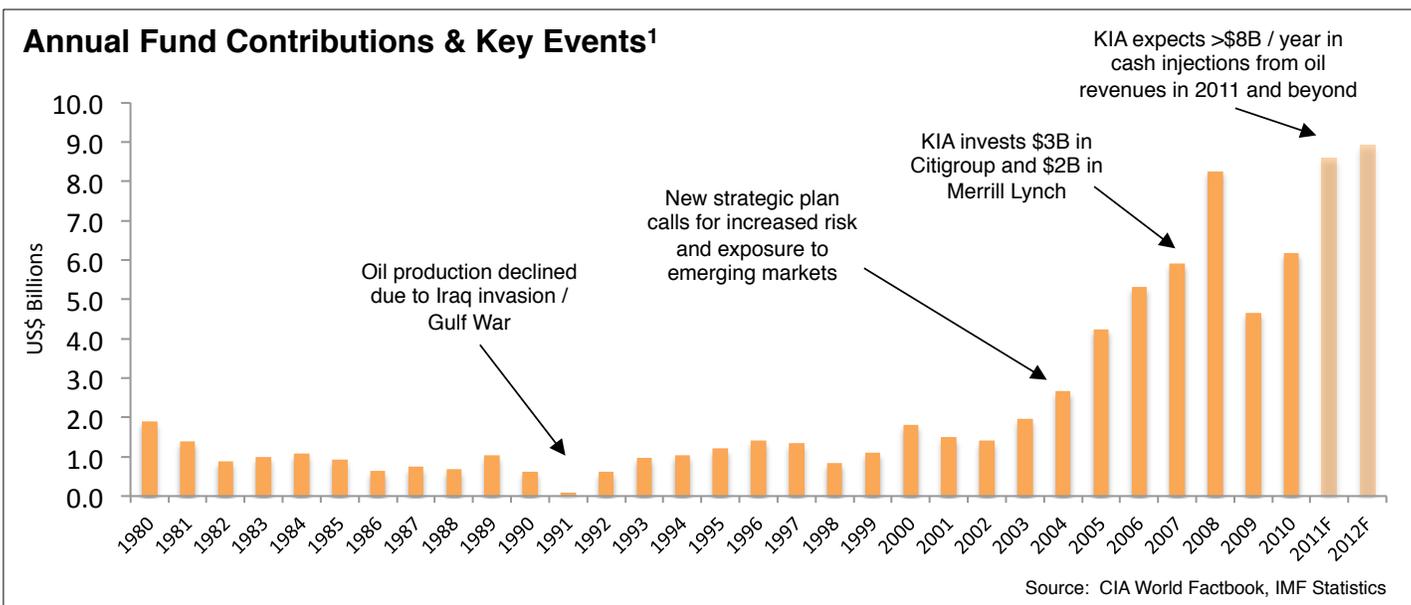
The KIA does not disclose the geographic breakdown of its portfolio. However, it does state that its goal is to achieve a breakdown consistent with each country's share of world GDP, with the exception of core holdings in companies such as Daimler AG or BP Plc. We also know that KIA has ramped up its presence within Kuwait's domestic economy lately (largely in real estate), and also in China (~\$10 billion invested to date). Historically, KIA has favored Europe over North American markets. Given the state of the EU economy, it has stated its current preference for UK assets.

Asset Allocation (2004 vs. 2010)



Source: KIA website

Since 2004, KIA has diversified away from equities and bonds, and into alternatives, such as private equity, real estate and hedge funds. It has also said it will increase the share of real estate in its portfolio by 10% in the near-term.



Political Risk:

Overview of Political System

- Independent since 1961, Kuwait is a constitutional monarchy, and has the oldest democratically-elected parliament in the Middle East. Despite this history of democracy, the Prime Minister has always come from the ruling family, a point of contention amongst many of its citizens. Criticism of the Emir is not tolerated and allegations of unfair election practices are common.

Domestic Political Risks

- The nation's democratic government can be an asset and a liability for KIA. The parliament is active, and involved in the forming of economic policy. Disagreements amongst Ministers can lead to delays in domestic investments. This is in stark contrast to many Middle Eastern countries.
- In the wake of the Arab Spring, political discontent, particularly amongst youth and non-residents could halt Kuwait's aggressive US\$8 billion development plan that calls for significant investment in non-hydrocarbon sectors, of which KIA will play a major role.
- While KIAs investments are generally not politically motivated, in recent years, government has called on KIA to play more of a role in the domestic economy, to stimulate the creation of strategic sectors.
- Kuwait has an active media, which scrutinizes its handling of state assets. KIA is learning to more proactively manage the discourse between the fund, the media, and the public.

Foreign Political Risks

- KIA, like many SWFs, has been prevented from investing in "strategic sectors", most notably by Germany and the U.S. It has been accused of seeking to advance its political power and stealing intellectual property through its investments. However, its long history with many developed economies has helped to build trust over time.

Recent Events:

12/2011 – KIA looking to invest in Mongolia

- The KIA has expressed interest in investing in mining, infrastructure, and agriculture in the near future.

11/2011 – KIA interested in large UK real estate deals

- The KIA stated that it views the UK as a relative safe haven amidst a troubled Europe and that it is keen to invest in large real estate / infrastructure deals (>£200B).

11/2011 – KIA reaffirms interest in EU rescue fund

- The KIA has raised the prospect of investing in the expanded EU EFSF rescue fund, pending further clarification on the investment terms.

03/2011 – KIA to invest \$3.6B in Kuwait Real Estate

- Citing attractive real estate prices, KIA announced a new fund, to be administered by Kuwait Finance House, to invest \$3.6B in Kuwait's commercial real estate sector.

Strategic Issues:

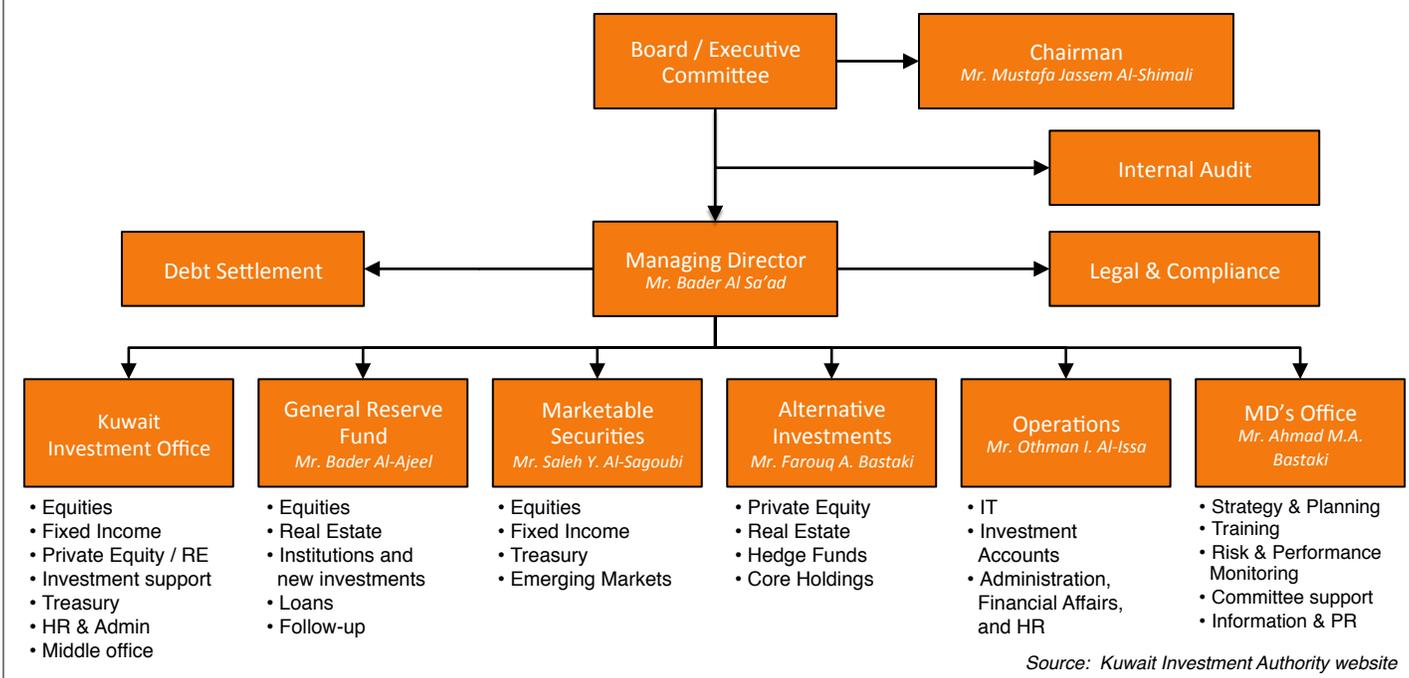
KIA struggling to cope with new domestic role

- Due to capital flight during the 2008 financial crisis, KIA was asked by parliament to scale up domestic investment to help stabilize the economy. The KIA is still re-orienting itself to this end, and learning how to invest at home.

Kuwaiti oil production could peak before 2015

- While the KIA has ample cash contributions coming in today, that soon could change as experts estimate Kuwait's oil production may peak in the next decade, which would mean less annual cash flow for KIA.

Organizational Structure



Key People:

Mr. Mustafa Jassem Al-Shimali – Chairman

- Currently the Minister of Finance for Government of Kuwait
- Served as Chairman of KIA since 2007

Mr. Bader M. Al Sa'ad – Managing Director (CEO)

- Appointed Managing Director in 2003
- First order was to commission the strategic investment review
- A trained accountant, his prior experience includes time as managing director of Kuwait Financial Center SAK and training stints at banks in New York and Chicago

Mr. Saleh Y. Al-Sagoubi – Exec. Director, Marketable Securities

- Responsible for all equity and fixed income investments
- Primary focus is North America, Europe and Asia

Mr. Farouq A. Bastaki – Exec. Director, Alternative Investments

- Responsible for PE, real estate and hedge fund investing
- Objective is to outperform relevant indexes by 100-500 bp

Mr. Bader Al-Ajeel – Exec. Director, General Reserve Fund

- Responsible for commercial and governments investments, such as Kuwait Petroleum Corp. and involvement with IMF/World Bank.

Mr. Othman I. Al-Issa – Exec. Director, Operations

- Responsible for IT, reporting, and overall administration of KIA

Mr. Ahmed M.A. Bastaki – Exec. Director, MD's Office

- Responsible for strategic planning and risk / performance review

Transparency

Linaburg-Maduell Transparency Rating (6 / 10)

- KIA places near the middle of the pack on transparency, largely because it does not disclose annual financial statements, nor does it provide detailed information of its holdings or external fund managers.

Laws bind KIA to non-disclosure

- Under law No. 47 (1982), KIA is bound by clauses 5, 8 and 9 to provide detailed reports to the Council of Ministers, but disclosure to the public of any information related to KIA's work is subject to strict penalties.

Governance:

Structure

- The KIA is an independent public authority managed by its board of directors, the majority of which must be from the private sector. An executive committee, made up of board members, monitors all of KIA's activities

Audit Process and Review

- Two external audit firms review, audit and approve KIA's financial accounts. KIA is required to submit statements of its assets to the State Audit Bureau semi-annually, and reports annually to the Council of Ministers, Kuwait's cabinet. KIA also appears before committees of Parliament periodically to discuss its performance.

Note: (1) Transparency rating based on the Linaburg-Maduell Transparency Index of Sovereign Wealth Funds
Source: KIA Website, SWF Institute, press releases, IMF International Working Group of Sovereign Wealth Funds

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