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Systemic Sovereign Financial Risk:

Re-Anchoring Sovereign Funds in the Sovereign's Policy Mandate

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EXECUTIVE SUMMARY

Sovereign funds remain part of the sovereign's wider financial condition even when operationally independent. This paper argues that the post-2008 governance settlement, while still essential, no longer captures the risk that now matters most: the systemic interaction of portfolio, fiscal, reserve, and external exposures under stress. It names this Systemic Sovereign Financial Risk (SSFR) and proposes Sovereign Resilience Management (SRM) as a diagnostic framework for addressing it. Drawing on the public sector balance sheet literature, the economics of sovereign self-insurance, and the Knightian distinction between risk and uncertainty, the paper argues that conventional sovereign asset-liability management is necessary but incomplete. SRM operates as a diagnostic layer rather than a directive one, leaving investment autonomy and the Santiago Principles intact; it asks whether the totality of public financial assets is coherent relative to the totality of sovereign risks.

The paper concludes that coherent stewardship of public assets is itself an expression of sovereign capacity.

ABOUT THIS SERIES

The Long Arc is a monthly series of concise, intellectually serious essays by well-regarded voices that examine the structural forces reshaping sovereign capital, technology, and global markets.

Introduction

Sovereign funds[1] were established with distinct legal mandates, governance structures, investment horizons, and performance benchmarks. The Santiago Principles gave that architecture its clearest international expression, emphasising sound governance, transparency, accountability, prudent investment practice, and operational independence.[2]

The model worked. It protected long-horizon public capital from discretionary political use, strengthened the credibility of sovereign investors in global capital markets, and reassured recipient countries that sovereign capital would behave as commercially oriented institutional capital rather than as an extension of state power.

But operational autonomy was never the same as economic detachment.

The sovereign's wider financial condition has become harder to compartmentalise. Fiscal pressures, public debt burdens, geopolitical fragmentation, climate-related liabilities, technological dependence, industrial policy demands, ageing-related obligations, and recurrent financial sector interventions now bear directly on the sovereign balance sheet.

The relevant challenge is no longer portfolio risk, reserve adequacy, debt management, or fiscal sustainability considered independently. It is a system-wide sovereign financial risk whose components have been studied in parts but rarely treated as a single analytical category, pressures across these dimensions reinforcing one another under stress.

[1] Since the Santiago Principles were adopted in 2008, the landscape of state-sponsored investment vehicles has broadened significantly. Beyond traditional sovereign wealth funds, states now operate a wider range of public asset and sovereign investment vehicles to hold, manage, deploy, and leverage sovereign financial resources, including catalytic and hybrid structures that combine sovereign and private capital. In this essay, "sovereign funds" is used in this broader institutional sense, while remaining anchored in the conventional sovereign wealth fund designation.

[2] International Working Group of Sovereign Wealth Funds, *Generally Accepted Principles and Practices: Santiago Principles*, October 2008. Available at ifswf.org/santiago-principles. The Santiago Principles are twenty-four voluntary principles that define the governance, accountability, transparency, and prudent investment practices expected of sovereign wealth funds. They remain the principal international framework for sovereign fund governance and the reference point against which the argument of this essay is set.

What has shifted?

The shift extends well beyond sovereign wealth funds. It reaches into the wider architecture through which states manage public financial assets and liabilities: reserve management frameworks, stabilisation funds, public pension arrangements, development banks, strategic holdings, and other state-owned investment vehicles.

Under earlier conditions of deeper globalisation, lower geopolitical fragmentation, and more stable macro-financial conditions, sovereign financial functions could be managed through segmented institutional structures. Central banks managed reserves. Sovereign funds managed long-horizon investment portfolios. Finance ministries managed fiscal operations. Debt management offices managed sovereign borrowing and refinancing risks. That separation reflected specialisation, mandate clarity, and institutional discipline. The functions were institutionally distinct, but never macroeconomically separate. What has changed is the scale, simultaneity, and transmission of their interactions under stress.

Three changes do most of the work.

The first concerns the sovereign balance sheet itself. The contingent claims bearing on sovereigns have become larger, less predictable, and more correlated during periods of stress. Climate adaptation, ageing populations, financial stability backstops, defence requirements, technological security investments, industrial policy demands, supply chain disruptions, and the fiscal aftereffects of pandemic and war now interact on public balance sheets in ways earlier frameworks did not anticipate. The IMF's work on public sector balance sheets has reinforced the point that sovereign assets and liabilities cannot be analysed separately.[3] Fiscal strength depends not only on debt and deficits, but on the quality, liquidity, governance, and risk characteristics of the assets the public sector owns.

The intergenerational logic underpinning many traditional sovereign wealth funds, formalised in Hartwick's rule on the conversion of exhaustible resource rents into reproducible capital, and developed in the subsequent literature on sustainability and intergenerational equity[4], remains valid. The proposition that finite resource wealth should be transformed into long-term financial wealth remains economically sound. The environment in which that logic operates is what has changed. Assumptions once treated as reliable, such as low inflation, deep market liquidity, open capital flows, predictable correlations, and smoother long-run growth paths, now appear less secure.

The second shift concerns the nature of sovereign financial assets themselves. The investable opportunity set has changed substantially. Private markets, infrastructure, private credit, digital systems, artificial

[3] International Monetary Fund, *Fiscal Monitor: Managing Public Wealth*, October 2018. The report argues that public sector balance sheets bring together what the state owns and owes, offering a broader fiscal picture beyond debt and deficits and strengthening risk management and policymaking.

[4] John M. Hartwick, "Intergenerational Equity and the Investing of Rents from Exhaustible Resources," *American Economic Review*, Vol. 67, No. 5, December 1977, pp. 972–974; Robert M. Solow, "On the Intergenerational Allocation of Natural Resources," *Scandinavian Journal of Economics*, Vol. 88, No. 1, 1986, pp. 141–149.

intelligence, and technology platforms now occupy a larger place in long-horizon portfolios, together with the custody systems, payment rails, cloud infrastructure, semiconductor supply chains, data architecture, and sanctions-sensitive financial networks on which they depend. For sovereign investors, these are no longer merely financial allocations. They form part of the infrastructure on which sovereign financing capacity, economic continuity, and national functioning depend, and they carry strategic and geopolitical characteristics as well as financial ones.

The 2022 freezing of a major sovereign's foreign exchange reserves following the invasion of Ukraine made the point concrete. Reserves that had been managed within an asset-only frame were revealed to be embedded in custodial, settlement, and jurisdictional structures whose strategic characteristics had not been priced into the original investment design.

None of this renders classical portfolio theory irrelevant. The Brinson-Hood-Beebower finding that strategic asset allocation accounts for the dominant share of return variation in long-horizon institutional portfolios remains foundational.[5] Strategic asset allocation, diversification, liquidity management, benchmark discipline, and institutional autonomy remain essential.

But the framework becomes incomplete when sovereign assets interact more directly with fiscal capacity, external vulnerability, technological dependence, and crisis response capability. The Brinson-Hood-Beebower result holds within the asset-only frame in which it was derived; this essay argues that the asset-only frame is no longer the right one appropriate for sovereign capital. The implication is not the abandonment of saving-investment discipline. It is the recognition that portfolio construction must now be situated within the sovereign's wider financial condition.

The third shift concerns the nature of the contingencies sovereigns now face. Pandemics, war, sanctions, cyber disruption, climate shocks, technological discontinuities, and supply chain fractures do not sit comfortably within the traditional vocabulary of measurable financial risk. They are closer to the Knightian category of uncertainty than to risk in its measurable sense, exposures for which probability distributions are unstable, correlations change sharply under stress, and effective hedges are either unavailable or themselves dependent on functioning markets.[6]

These are not merely risks that markets misprice or hedge imperfectly. They are sovereign contingencies or unknown unknowns in terms of size and timing of the liability, for which meaningful commercial insurance often does not exist at scale.

[5] Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, "Determinants of Portfolio Performance," *Financial Analysts Journal*, Vol. 42, No. 4, 1986, pp. 39–44; Brinson, Singer, and Beebower, "Determinants of Portfolio Performance II: An Update," *Financial Analysts Journal*, Vol. 47, No. 3, 1991, pp. 40–48.

[6] Frank H. Knight, *Risk, Uncertainty, and Profit*, Boston: Houghton Mifflin, 1921.

Sovereigns self-insure because they cannot fully insure. The economics of sovereign self-insurance have been studied principally in the context of foreign exchange reserve accumulation[7] but the underlying logic extends well beyond reserves.

Reserves, stabilisation funds, pension buffers, development banks, savings funds, and strategic holdings collectively constitute a broader sovereign resilience architecture. Yet in many countries, these institutions are still governed, stress-tested, and assessed largely in isolation from one another.

That creates an analytical blind spot. Liquidity that appears inefficient relative to a conventional portfolio benchmark can be rational when assessed against the sovereign's broader contingent liabilities. Asset allocations that appear diversified within an individual fund may still represent concentration when viewed against the sovereign's wider external, technological, or strategic exposures.

The design question is therefore changing. It is no longer sufficient to ask whether a sovereign fund is well governed as a standalone institutional investor. One must also ask whether sovereign funds are appropriately positioned within the sovereign's wider resilience architecture.

Systemic sovereign financial risk

The risk that emerges from this changed environment can be more precisely named. It is not portfolio risk, fiscal risk, reserve adequacy, or external sector vulnerability considered independently. It is the *systemic interaction* of these exposures under stress within the sovereign's wider financial architecture. This is the essence of Systemic Sovereign Financial Risk (SSFR).

SSFR is distinct from the sovereign risk assessed by rating agencies, which focuses on default probability, and from systemic risk as defined in the macroprudential literature, which centres on the financial system. It concerns, instead, the internal coherence of the sovereign's combined financial position: how the sovereign's assets, liabilities, liquidity, and contingent claims interact under stress or in a crisis.

The empirical case for naming this risk explicitly has strengthened over the past two decades. Successive crises — the 2008 global financial crisis, the European sovereign debt crisis, the COVID-19 pandemic, and the financial dislocations following the 2022 invasion of Ukraine, have demonstrated that the lines between portfolio losses, fiscal stress, reserve drawdowns, refinancing pressure, and contingent liability crystallisation are far less stable in practice than in the institutional frameworks that manage each separately.

[7] Joshua Aizenman and Jaewoo Lee, "International Reserves: Precautionary Versus Mercantilist Views, Theory and Evidence," *Open Economies Review*, Vol. 18, No. 2, 2007, pp. 191–214; Olivier Jeanne and Romain Rancière, "The Optimal Level of International Reserves for Emerging Market Countries," *Economic Journal*, Vol. 121, No. 555, 2011, pp. 905–930; Maurice Obstfeld, Jay C. Shambaugh, and Alan M. Taylor, "Financial Stability, the Trilemma, and International Reserves," *American Economic Journal: Macroeconomics*, Vol. 2, No. 2, 2010, pp. 57–94.

The literature on the recurrence and correlation of sovereign stress episodes has documented this empirically.[8]

The COVID-19 response made this visible. Sovereign funds in several jurisdictions were drawn into stabilisation roles that their mandates, ex ante, had not anticipated, providing domestic liquidity, supporting state-owned enterprises, or financing public health and social protection responses. The Santiago Principles' commitment to operational autonomy did not prevent this, but neither did the institutional architecture surrounding the funds explicitly prepare for it.

Sovereign wealth funds, reserve portfolios, public pension systems, development banks, public corporations, and strategic state holdings may operate under separate institutional mandates. They nevertheless interact within the same sovereign risk structure.

Sovereigns also differ fundamentally from conventional institutional investors. Unlike private actors, sovereigns possess policy powers that can alter the structure of liabilities and the transmission of financial stress. They can tax, regulate, borrow, restructure obligations, provide guarantees, impose capital restrictions, and redirect public resources during crises.

That makes the sovereign's liability structure partly endogenous in ways that do not apply to private balance sheets. It also means that sovereign-held assets cannot be analysed independently of the sovereign's wider policy capacity, institutional credibility, and crisis- management framework.

The resilience implications follow directly. In the financial system, banks conduct scenario-based stress tests. Insurers do the same. Central banks increasingly stress-test the balance of payments as part of external sector and exchange rate management, and the banking system, as part of their financial stability assessments. Yet sovereign financial risk architectures are still rarely assessed through integrated stress scenarios. Reserve adequacy, refinancing pressures, contingent swap lines, liquidity access, sanctions exposure, collateral mobilisation, cyber vulnerabilities, technology dependencies, climate shocks, and contingent fiscal liabilities are typically examined through separate institutional exercises, a fragmentation that is becoming harder to sustain.

The shocks themselves do not respect institutional boundaries.

What is needed is a framework that directly addresses systemic sovereign financial risk while preserving the institutional autonomy of sovereign funds that the Santiago Principles rightly protect.

From managing sovereign funds to managing sovereign resilience

That framework is, in part, an extension of the disciplines used to manage sovereign assets and liabilities jointly. But it must be a broader extension than those disciplines have conventionally been asked to provide.

[8] Carmen M. Reinhart and Kenneth S. Rogoff, *This Time Is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009. See also IMF, *Global Financial Stability Report*, recent editions; and BIS, *Annual Economic Report*, recent editions.

The conventional approach to managing sovereign assets and liabilities, codified in the IMF and World Bank guidelines on public debt and reserve management[9], and often labelled sovereign asset-liability management, is strongest where obligations can be estimated with reasonable confidence. It works well for liabilities whose maturity, currency composition, duration, refinancing profile, liquidity needs, and fiscal costs are measurable. It rests on the premise of liability measurability: that sovereign obligations can be characterised by stable probability distributions and that assets can be matched against these distributions. The disciplines this implies remain essential. Sovereigns must understand the structure of their debt, the liquidity of their reserves, and the fiscal risks embedded in guarantees, public corporations, pension systems, and financial sector backstops.

But the conventional approach, while necessary, is incomplete in three respects that matter for the argument of this essay.

- **First,** the premise of liability measurability is precisely what the third shift identified above puts under pressure. Many of the most consequential shocks sovereigns now face cannot be treated as measurable liabilities with stable probability distributions. They are Knightian exposures whose timing, scale, transmission channels, and financial consequences are deeply uncertain.
- **Second,** the conventional approach as typically practiced is largely devoid of scenario logic. Its strength lies in matching assets to liabilities along measurable dimensions like currency, duration, and maturity under broadly stable macro-financial conditions. It is less well equipped to assess how the sovereign's combined financial position would behave under severe, simultaneous, and partly correlated stresses across multiple dimensions. The shocks that matter most for sovereign resilience are precisely those the conventional framework is least equipped to model. Too often, discipline is treated as an accounting exercise rather than as an instrument of policy.
- **Third,** sovereign funds complicate the framework in ways the conventional approach was not designed to accommodate. Sovereign funds are not contracted liabilities. They are public-purpose vehicles whose mandates such as stabilisation, intergenerational savings, strategic resilience, or some combination, embed implicit obligations to future fiscal generations, to macroeconomic stability, and to the sovereign's wider policy capacity. These implicit obligations interact with the sovereign's measurable liabilities in ways that asset- or liability-side analysis alone cannot fully capture. Reduced to mechanics, the discipline augments allocations against benchmarks without engaging the public purposes the assets exist to serve.

The design problem, therefore, changes. The sovereign balance sheet must now be resilient not only against quantified liabilities but also against contingencies whose magnitude and timing cannot be known in advance, against scenario interactions that the conventional framework does not model, and against the public-purpose obligations that sovereign funds implicitly carry. The issue is no longer simply matching

[9] Udaibir S. Das, Yinqiu Lu, Michael G. Papaioannou, and Iva Petrova, "Sovereign Risk and Asset and Liability Management: Conceptual Issues," IMF Working Paper WP/12/241, October 2012; IMF and World Bank, *Guidelines for Public Debt Management*, revised edition; IMF, *Revised Guidelines for Foreign Exchange Reserve Management*, 2013.

assets against predictable obligations. It is ensuring that the sovereign retains sufficient financial flexibility, liquidity, institutional capacity, and strategic optionality under conditions of severe stress.

That is the underlying logic of sovereign self-insurance, and its absence is leading many sovereigns to seek insurance and pay what has been called a "sovereignty premium." Private markets can absorb portions of these exposures. They cannot insure the sovereign condition itself.

The framework this calls for is Sovereign Resilience Management (SRM). SRM re-anchors sovereign funds more explicitly within the sovereign's broader balance sheet and crisis management framework, while preserving their operational autonomy and governance in accordance with the Santiago Principles.

SRM extends the joint management of sovereign assets and liabilities in three respects. It widens the liability concept to include Knightian contingencies alongside measurable obligations. It treats the sovereign's combined financial institutions as a single resilience architecture rather than a set of independent portfolios. And it places diagnostic analysis at the sovereign level, complementing rather than displacing each institution's operational autonomy.

A fourth feature distinguishes SRM from institutional risk management in a more fundamental way. The sovereign's liabilities are partly endogenous: unlike a private investor, the sovereign holds policy powers to tax, regulate, restructure, and guarantee, which alter its own liability structure and the transmission of stress. SRM must account for those powers rather than treat liabilities as externally given. This is what makes it a sovereign framework rather than a scaled-up portfolio framework.

SRM is not intended to centralise investment decision-making or subordinate sovereign funds to short-term fiscal objectives. It is intended to assess sovereign financial institutions against the sovereign's broader contingent liabilities, crisis-management requirements, and long-term resilience needs. Operationally, this requires integrated sovereign stress testing, consolidated balance sheet mapping, sovereign-wide liquidity frameworks, and institution-level contingency arrangements aligned with broader crisis planning.

An illustrative set of instruments for operationalising SRM is presented in more detail below.

The integrated sovereign view

SRM rests on a consolidated analytical framework rather than a consolidated institutional one. Nothing in it requires merging institutions. Its purpose is to assess how sovereign-held assets, liabilities, liquidity structures, contingent obligations, and crisis financing capacity interact under stress. The question is not whether individual institutions are well-managed in isolation, but whether the sovereign's combined financial position is resilient to the shocks it is implicitly expected to absorb.

This extends beyond conventional portfolio management. It also goes beyond the conventional joint management of sovereign assets and liabilities. That tradition has long recognised the importance of

assessing assets and liabilities together, particularly regarding debt sustainability, reserve adequacy, currency mismatches, and macro-financial vulnerability.

The IMF's external sector framework has developed similar joint analysis on the external side, assessing reserve adequacy and external positions against current account, capital flow, and exchange rate dynamics.[10]

The integrated sovereign view builds on both traditions. It applies them to a wider set of systemic exposures such as geopolitical fragmentation, technology dependence, sanctions resilience, liquidity mobilisation, climate contingencies, and institutional capacity under stress.

The questions this raises are operational as much as analytical.

- How liquid is the sovereign's combined public asset base during a systemic shock?
- How do sovereign fund assets interact with reserve adequacy, refinancing pressures, and external vulnerability?
- Which assets can be mobilised under stress without undermining long-term national objectives? What currency, custodian, settlement, jurisdictional, or technology concentrations exist across sovereign portfolios?
- Which contingent liabilities are implicitly backed by sovereign-held assets, which institution is best able to pay them out, and what are the implications for rebalancing?

A stylised case shows what is at stake. Consider a sovereign that holds foreign reserves concentrated in one reserve currency, a savings fund weighted toward global technology equities, and a contingent liability from guarantees extended to a state-owned enterprise. Each position may look prudent within its own institution: the reserves are liquid, the fund is diversified by sector and geography, and the guarantee is within fiscal limits. Yet under a combined stress like a sanctions episode that impairs the reserve currency, a technology-sector correction, and the crystallisation of the guarantee at the same moment, the three positions move together. The reserves are less usable than they appeared, the fund's diversification does not hold, and the guarantee falls due precisely when liquidity is scarce. Three separate institutional assessments, each reporting that its own position is sound, would miss this entirely. An integrated sovereign view makes the correlation visible before stress or crisis arrives.

No single sovereign fund can answer these alone. Nor can a debt office, central bank, finance ministry, or public pension authority act independently. The challenge is inherently cross-institutional. What is missing in most economies is a sovereign-level diagnostic function. Some elements of this already exist in partial form, such as debt sustainability analyses, financial sector assessments, and, in some systems, public sector balance sheet statements and contingent liability registers. What is absent is the framework that brings them

[10] International Monetary Fund, *External Sector Report* (annual), and the External Balance Assessment methodology developed in IMF Working Paper WP/13/272.

together into a single view and accounts for system-wide macrofinancial interactions across the economic system.

Its institutional location will differ. In some systems, it may sit within the finance ministry. In others, within the central bank, an independent fiscal institution, a sovereign balance sheet office, or a joint committee linking the relevant public financial institutions.

The precise location matters less than the existence of the function itself. Someone within the sovereign architecture must be responsible for asking the systemic risk question and answering it analytically and credibly.

The shift the integrated sovereign view proposes is summarised in Appendices 1 and 2.

The objection that must be taken seriously

The case for SRM and the integrated and coordinated sovereign view rests on the analytical claim that segmented institutional management is no longer adequate for the emerging sovereign environment. That claim invites a serious objection, and it must be engaged directly before the practical implications of the framework can be set out.

The objection is that the institutional settlement surrounding sovereign funds was designed precisely to shield long-horizon public capital from short-term political demands.

Operational independence, arm's-length governance, benchmark discipline, and clear legal mandates were not accidental features. They were protections. Placing sovereign funds more explicitly within the sovereign's broader financial condition risks opening the door to politically directed investment, quasi-fiscal activity, domestic bailouts, industrial-policy allocation, or politically motivated portfolio decisions. The Santiago Principles were drafted with precisely this concern in mind, and the institutional autonomy they protect is not an incidental feature of the framework but its central commitment.

The concern is legitimate. But it rests on an assumption that is becoming harder to defend: that sovereign funds can remain functionally insulated from the sovereign's wider financial condition simply because governance frameworks are formally separated.

A second objection is practical rather than political: that a sovereign-level diagnostic function adds coordination burden and cost and may not function well where institutional capacity is thin. That concern is real, and the essay returns to it below; it argues not for uniform adoption but for sequencing matched to institutional readiness.

The shocks documented in the previous sections already shape the environment in which sovereign funds operate, whether or not governance frameworks recognise those linkages. The choice is therefore not between a pristine separation and political integration. It is between unmanaged erosion under pressure

and a deliberate framework that recognises systemic interdependence while preserving operational autonomy.

The distinction that resolves the objection is the distinction between diagnostic and directive authority. The integrated sovereign view (SRM) proposed here is diagnostic. Its purpose is to identify system-level vulnerabilities, resilience gaps, liquidity pressures, and strategic concentrations across the sovereign balance sheet.

It may shape the outer parameters within which sovereign financial institutions operate — including liquidity tolerance, resilience requirements, currency exposure, and crisis preparedness. But it should not determine individual investment decisions, asset selection, manager appointments, project allocation, or commercial strategy. Those decisions must remain within the sovereign fund's own governance and fiduciary framework. SRM does not displace the Santiago Principles' commitments to operational independence; they are reinforced by the explicit separation of diagnostic from directive authority.

Three safeguards make the distinction operational. The sovereign fund's operational mandate and governance autonomy should remain legally protected. Transparency, disclosure, and legislative or equivalent public oversight become more important under an integrated framework, not less, because political misuse is easier where sovereign financial arrangements are opaque. And the integrated sovereign view is not a substitute for institutional quality; where domestic governance remains weak, strengthening the sovereign fund's legal mandate, board independence, reporting standards, audit arrangements, and investment discipline should take precedence over more ambitious forms of sovereign-wide integration.

The objection, therefore, yields a refinement of the framework rather than a refutation of it. Caution is warranted. But the sovereign's financial condition has already become more interconnected, and the question is whether sovereign governance frameworks adapt to that reality deliberately and transparently, or only after stress forces the adjustment implicitly.

What changes for sovereign owners and funds?

If the analytical case holds and the diagnostic-directive distinction is preserved, the practical implications may be considered as follows:

Mandate and design

The establishment, review, and reform of sovereign funds should begin not with a standalone portfolio rationale, but with the sovereign's wider financial condition. The relevant questions extend beyond benchmark construction and investment mandate. What sovereign exposure is the fund implicitly hedging or amplifying? How does it interact with reserve adequacy, refinancing risk, and external vulnerability? What contingent liabilities may ultimately depend on it? What role might it play during stress episodes? Which strategic or operational concentrations does it create across the sovereign balance sheet?

Accountability and performance

These questions matter because accountability today remains organised largely institution by institution. Each sovereign fund, reserve manager, public pension fund, or development institution reports against its own mandate, benchmark, and governance framework. That remains necessary. It does not, however, establish whether the sovereign's combined public financial position is coherent relative to the risks it faces. The integrated sovereign view is intended to fill that gap.

Measuring sovereign funds solely against conventional market benchmarks implicitly treats them as standard institutional portfolios with a single fiduciary objective. That is incomplete. Sovereign fund performance must also be assessed against the public purposes for which the fund was established to serve; such as stabilisation, intergenerational savings, liquidity support, strategic resilience, or some combination of these.

Liquidity and concentration

Liquidity illustrates the point clearly. A sovereign fund holding more liquid assets than a conventional portfolio model may appear inefficient in ordinary periods. Yet that same liquidity may materially reduce sovereign dependence on emergency borrowing, forced asset sales, impaired market access, or external conditionality during stress episodes. Portfolios optimised for normal conditions may prove to be least valuable precisely when sovereign capacity matters most.

The same logic applies to concentration risk. Concentration is no longer only exposure to sectors or asset classes. It may arise through currencies, jurisdictions, custodians, settlement systems, technology platforms, cloud infrastructure, payment networks, or sanctions-sensitive channels. A portfolio may appear diversified from a market perspective while remaining concentrated from a sovereign risk perspective.

Operational design

Much of what the integrated sovereign view implies can be advanced at the fund level without waiting for a sovereign-level diagnostic function to be established.

Sovereign fund boards can ask, in their own scenario work, how the fund's liquidity, currency, custodial, and technology positions would interact with the sovereign's wider exposures under stress and can stress-test on that basis.

Investment policies can be reviewed to identify implicit concentrations that look diversified within the portfolio but are concentrated against the sovereign's external or strategic position. Risk disclosure can be expanded to acknowledge the public purposes the fund supports alongside its market performance. Engagement with finance ministries, central banks, and debt offices can be made more systematic — not as a step toward integration of decision-making, but as a means of ensuring that each institution understands the others' positions before stress forces the conversation. These steps require no change in

mandate or governance. They prepare a fund to operate coherently within an integrated framework when one emerges, and they strengthen its position in the meantime.

Two further implications deserve attention.

- The first clarifies an important misconception. Passive investing (indexing) is not inherently inconsistent with sovereign resilience. The problem is passive governance. Sovereign-held assets cannot be treated as if they exist independently of the sovereign's liquidity needs, contingent liabilities, strategic dependencies, and crisis response requirements.

- The second is the deeper implication of everything above. Sovereign funds now form part of the sovereign's implicit resilience and self-insurance architecture. For instance, countries can hedge specific climate risks with catastrophe bonds that pay out when disaster hits. They can also consider resilience bonds to offset future climate-related liabilities, which often reduce their cost of debt issuance. This can be done both the national and regional levels.

They are not insurance vehicles in a narrow actuarial sense, but they will offset contingent liabilities that the sovereign may face. Thus, these assets may ultimately support sovereign responses to contingencies for which no meaningful external insurance market exists at a larger sovereign scale.

That reality should be reflected more explicitly in mandate design, liquidity frameworks, stress testing, and risk disclosure.

What changes for markets and the international framework?

The implications extend beyond sovereigns themselves.

Asset managers, advisers, and international financial institutions have traditionally approached sovereign funds primarily as long-horizon and "patient" institutional investors with relatively stable liabilities and clear investment objectives. That analytical frame is becoming less adequate for the sovereign environment now emerging. Sovereign clients operate amid portfolio risk, fiscal risk, refinancing pressure, reserve adequacy, geopolitical exposure, technology dependence, and systemic contingency simultaneously.

Portfolio advice detached from the sovereign's broader balance sheet may remain technically sophisticated yet still miss the sovereign problem that must ultimately be managed. Those with sovereign counterparts who can combine portfolio expertise with a deeper understanding of sovereign balance sheets, contingent liabilities, crisis liquidity, and systemic resilience will be better placed to advise sovereign clients in the decade ahead.

The implications for the international governance framework follow.

Asset reform as one layer of state capacity

The argument of this essay has been framed in terms of public balance sheets, contingent liabilities, and sovereign resilience. That framing is necessary. But it should not become too narrow, and the asset-side discussion should not become mechanical.

The deeper question is how states turn resources into sustained capabilities, such as industrial, financial, administrative, and institutional. Public assets and liabilities become strategic only when embedded in a broader architecture of governance, discipline, and long-term state capacity. Stripped of that context, the most carefully designed asset-and-liability framework will deliver less than it promises.

The sharper framing is therefore this. Public balance sheet reform is not the end point. It is an operating layer of state capacity. Without visibility and governance of public assets and liabilities, that capacity is weaker. But without capable institutions to design, implement, and sustain such governance, reform of the balance sheet alone goes nowhere.

This has a practical bearing on how the integrated view of sovereign financial risk should be advanced. In jurisdictions with strong institutional foundations, an integrated diagnostic function can be added to an already coherent governance architecture, and the gains are likely to be substantial.

An integrated sovereign view is not only a defence against loss. Coherence across the sovereign balance sheet can lower the cost of capital, strengthen credit standing, and widen fiscal space. Resilience and capacity are two sides of the same discipline.

In jurisdictions where institutional capacity is uneven, the order of priorities is different. Strengthening the underlying institutions including finance ministries, central banks, sovereign wealth funds, debt offices, and oversight bodies becomes a prior condition. Asset architecture without institutional capacity, for instance, is a presentation rather than a system. The political economy of establishing a sovereign-level diagnostic function varies considerably across jurisdictions, and the sequencing of any such reform should be designed with that variation in view; the present essay does not attempt to prescribe it.

The international framework should reflect this dependency. The next stage of evolution beyond the Santiago Principles is not only about updating the good principles governing sovereign funds. It is about recognising that sovereign financial governance is one expression of broader state capability, and that the capacity to manage public assets coherently is itself a measure of how seriously a sovereign takes its own long-term position.

Conclusion

The argument of this essay can be put briefly.

Sovereign funds can no longer be governed as if operational autonomy were equivalent to economic detachment. The post-2008 settlement rightly protected funds from short-term political and fiscal pressures. That protection remains essential. But sovereign funds remain part of the sovereign's broader financial condition, and their governance must now recognise that fact more explicitly.

The relevant risk has changed in character. It is no longer adequate to assess portfolio risk, fiscal risk, reserve adequacy, or external vulnerability in separate institutional compartments. The risk that matters is the systemic interaction of these exposures under stress, and managing it requires a framework that most systems currently lack.

The response proposed here, Sovereign Resilience Management, is diagnostic rather than directive. It does not centralise investment decisions, weaken operational independence, or replace the Santiago Principles. It asks a prior question that sovereigns too rarely ask directly: whether the totality of public financial assets is coherent relative to the totality of sovereign risks. Answering that question requires a sovereign-level diagnostic function, integrated stress testing, and clearer recognition of the implicit self-insurance role that sovereign-held assets now perform.

The challenge is to preserve operational independence while recognising more explicitly that sovereign financial institutions ultimately operate within the sovereign's wider financial condition, and that the discipline of managing public assets coherently is itself one expression of a state's capacity to govern its own long-term position.

APPENDIX 1

From segmented institutional management to Sovereign Resilience Management

Dimension	Conventional institutional approach	Sovereign Resilience Management
Unit of analysis	Individual institution: SWF, reserve manager, debt office, pension fund	The sovereign balance sheet as a whole
Risk frame	Portfolio risk, fiscal risk, reserve adequacy, external vulnerability — assessed separately	Systemic interaction of these exposures across scenarios and under stress
Asset-liability logic	Joint management is applied within each institution's mandate	Sovereign-wide joint management extended to contingent and uncertain exposures
Liquidity	Optimised against institution-level benchmarks	Assessed against the sovereign's combined contingent obligations
Concentration	Diversification within an individual portfolio	Concentration across currencies, jurisdictions, custodians, settlement systems, and technology platforms
Stress testing	Fragmented institutional exercises	Integrated sovereign scenarios spanning war, pandemics, sanctions, cyber, climate, refinancing stress
Governance	Operational autonomy of each institution	Operational autonomy preserved; diagnostic function added at the sovereign level.
Performance assessment	Market benchmark relative to mandate	Market benchmark plus the public purposes the institution is established to serve

APPENDIX 2

Illustrative instruments for re-anchoring sovereign funds within Sovereign Resilience Management

Sovereign Resilience Management requires instruments, not only principles. The toolkit below moves from the analytical foundations of a sovereign-level view, through the operational instruments that put it to work, to the governance safeguards that keep it honest. It is illustrative rather than exhaustive.

Consolidated sovereign balance sheet map.
Bringing together reserves, sovereign funds, public pension assets, development banks, public corporations, guarantees, debt, and contingent liabilities in a single analytical view.

Sovereign risk bucket framework.
Distinguishing between liabilities whose timing and scale are broadly known and contingencies where timing, scale, or both remain uncertain. Strategic asset allocation should be informed by these categories, rather than derived from asset optimisation alone.

Liquidity and collateral framework.
Identifying which assets can be sold, used in repo transactions, pledged, or otherwise mobilised under stress without undermining long-term objectives. Some sovereigns may choose to maintain larger liquidity buffers than traditional portfolio models imply, accepting lower returns in exchange for financial flexibility. Others may rely more heavily on repo markets, collateral mobilisation, and contingent swap lines or lines of credit. Most sophisticated sovereigns will likely operate between these poles.

Integrated sovereign stress testing.
Covering combinations of war, pandemics, sanctions, cyber disruption, reserve loss, refinancing stress, climate events, and market closure, rather than assessing them only through fragmented institutional exercises.

Institution-level crisis protocols.
Aligned with the sovereign-wide framework. Sovereign funds, reserve managers, debt offices, development banks, and public pension entities should each maintain crisis management and stress response arrangements consistent with the sovereign's overall resilience framework.

Mandate and benchmark review.
Strategic asset allocation should no longer be derived solely from an asset-only framework. It should also reflect the sovereign liabilities, liquidity needs, and contingency buckets the institution is implicitly expected to support.

Governance safeguards.
Sovereign Resilience Management should shape mandate design, liquidity tolerance, currency posture, stress preparedness, and resilience requirements. It should not select assets, managers, projects, or

counterparties. Those decisions must remain within the operational governance of each sovereign fund or related institution.