

# THE EVOLVING POLITICS OF SOVEREIGN WEALTH FUNDS

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In recent years, sovereign wealth funds (SWFs) have grabbed the international spotlight, igniting intense debate. Sensing the difficult political terrain that they must navigate, such funds have generally adopted a low profile. And by offering attractive financing terms and generally taking passive minority positions in the companies in which they invest, they have been a desirable source of capital for distressed companies. Maintaining a low profile has been a wise political choice, and last year's calls to regulate these funds have quieted down. However, the severe global financial crisis and a concomitant shift in the geopolitical and economic landscape in the United States, Europe and other OECD countries may present these funds with their greatest political and economic challenges yet.

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While Paris burns (as do countries and markets around the world), one might assume that SWFs, by providing cash infusions to faltering financial institutions and other falling stars, would be able to raise their political capital, but this is not necessarily the case. "I will not be the French President who wakes up in six months time to see that French industrial groups have passed into other hands", President Nicolas Sarkozy remarked<sup>1</sup>, insisting that France needs to protect its national companies from foreign "predators". He fears that SWFs will amass too much power if permitted to invest in important French

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businesses while the souring global economy drives down acquisition costs. Sarkozy has decided that France should start its own fund to shield French enterprises from foreign investments. These policies reflect what many experts say the global economy cannot afford in the current environment (protectionism and “beggar they neighbor” policies).

Other European nations may not follow suit. Indeed, the British government, led by Prime Minister Gordon Brown, has actively courted investment in British businesses by SWFs. “The UK government welcomes the positive role that sovereign wealth funds... have in the efficient allocation of capital and the benefit that they bring to the global economy by taking a long-term view of their investment decisions”, Brown wrote<sup>2</sup>. Meanwhile Germany vehemently opposed Sarkozy’s suggestion that European nations collaborate to establish a common protectionist fund. Michael Glos, Germany’s economics Minister, said that such a policy “contradicts all the successful principles of our economic policy”<sup>3</sup>.

In the United States, as Barack Obama takes the reins of power and Democrats solidify their hold on Congress, SWFs regulation is on hold as government focuses on the credit crisis and the faltering economy. But this may be the calm before the storm. Pushed by the near collapse of the US financial system, high profile failures in the banking and securities industries, and unprecedented government intervention, increased regulation and indeed an overhaul of the entire US financial regulatory system is on the Congressional agenda for 2009<sup>4</sup>.

SWFs have their backers, at least for now, while their funds are badly needed. “We need the money”, proclaimed Barney Frank (D-MA), the Chairman of the US House Financial Services Committee. “The infusion of money is helpful... We’d be worse off without it”<sup>5</sup>. But it is difficult to see how SWFs can escape a tighter regulatory grip when private equity funds, hedge funds and other non-bank financial institutions - appear unlikely to escape Congressional scrutiny unscathed. Indeed, one of the main arguments SWFs have relied on to muster support for an open investment environment in recipient countries - that domestic and foreign pools of capital should be treated on a level playing field - may soon work to their disadvantage<sup>6</sup>. Even before the collapse in December of Bernard L. Madoff Investment Securities, the financial crisis that accelerated in September 2008 brought new calls for increased oversight of hedge funds, including Congressional testimony by various hedge funds managers in November 2008 that regulatory oversight would be appropriate. The political and regulatory challenges that SWFs face in the United States are explored in the last section of this article.

The fate of SWF investment depends not only on the political and economic circumstances in recipient countries, but the environment in their home countries. The negative returns that many SWFs have received on their recent investments have had the effect of putting many of these funds on the defensive. At the same time, the home countries of many funds have not been immune from the financial crisis, particularly with the fall in commodity prices and the decline in exports to industrialized nations, and managers are facing increased pressure to make domestic investments.

The first part of this article provides background information on SWFs, showing how the investment strategy of such funds has evolved in recent years towards riskier investments in foreign markets, a trend that has begun to reverse during the current financial turmoil. We then discuss SWF investment from the vantage point of recipient countries and summarize their concerns. The third section discusses whether the recent adoption of the Santiago Principles by many of the most important SWFs, and the adoption of OECD guidance to SWFs, is likely to forestall regulation. In the final section, we explore the multifaceted challenges that SWFs face in the United States, in the context of the incoming Obama administration and Democratic control of the US Congress. While the last section focuses on the political outlook for such funds in the United States, the US perspective on these funds is likely to have broader implications for SWFs in other OECD recipient countries.

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### *BACKGROUND ON SOVEREIGN WEALTH FUNDS*

The investment goals of SWFs are as varied as the nations that establish them. However, SWFs are often identified in two broad categories according to the source of their foreign exchange assets: commodity and non-commodity funds<sup>7</sup>. Commodity SWFs are funded with revenue derived from commodity exports. Typically established by oil-rich nations, these funds serve different purposes, such as fiscal revenue stabilization, preservation of inter-generational wealth and balance of payments sterilization. Non-commodity SWFs are established through assets transferred from official foreign exchange reserves. Due to balance of payments surpluses, nations with non-commodity SWFs have accumulated more reserves than what the government considers necessary to defend the country against financial shocks. These “excess” foreign exchange reserves are deposited into SWFs and managed separately from official reserves<sup>8</sup>.

SWFs have changed dramatically over the last half-century. The

first SWF, the Kuwait Investment Office, was created in 1953 for the purpose of investing surplus oil revenues to reduce Kuwait's reliance on its finite oil resource<sup>9</sup>. The fund created little controversy until 1987, when it purchased over 20% of British Petroleum, which had recently been privatized. The British government, concerned that a foreign country would own such a large percentage of the company, forced the Kuwaitis to sell over half of their stake<sup>10</sup>.

However, it was only in recent years that SWFs increased rapidly in number and size, arousing public interest. At least twenty new SWFs have been created since 2000<sup>11</sup>. There are now more than thirty-seven SWFs that collectively control between \$2 trillion and \$3 trillion in financial assets<sup>12</sup>. Analysts project that these funds will continue to grow, potentially amassing \$12 trillion in wealth by 2015<sup>13</sup>. To put these numbers in perspective, in September 2007, total assets under management by private hedge funds were estimated to be around \$2 trillion, US GDP was approximately \$12 trillion, the total value of traded debt and equity securities denominated in US dollars was estimated at over \$50 trillion, and the global value of traded securities was estimated at approximately \$165 trillion<sup>14</sup>. In this context, the wealth of SWFs is significant, but their existence should not automatically set off alarms or lead to paranoia.

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The increased size of SWFs in recent years has encouraged many fund managers to shift investment strategies. Following the old adage that "increased risk leads to greater rewards" and courted by cash-strapped countries and companies, many SWFs now have substantial assets invested in equity markets throughout the world. No longer do these funds invest only in US Treasury bonds.

However, the global economic downturn and volatility in the equity markets has reduced their profitability. Although only a handful of SWFs disclose performance information, it is not difficult to deduce what is happening to funds that have taken major equity stakes. Some SWFs have suffered portfolio losses of as much as 25% last year<sup>15</sup>. Having suffered major losses on their equity investments, and facing pressure at home, fund managers are understandably reluctant to invest<sup>16</sup>. SWFs face increased scrutiny from the citizens that were supposed to benefit from SWF investments<sup>17</sup>. The most risk averse funds are now turning away from equity markets instead of "bargain hunting" for undervalued stocks.

Diminished returns have contributed to a slower growth rate among SWF, but there is another reason these funds are less robust than they were at the end of 2007 - they simply have less money to invest. Many funds, particularly those based in oil-rich Middle Eastern countries, are seeing lower revenue as commodity prices fall,

and are instead accumulating cash, showing little appetite for buying shares in distressed Western companies<sup>18</sup>. Worldwide demand for oil has dropped and the record profits enjoyed by commodity-driven economies have waned. Similarly, in many non-commodity economies, export receipts have fallen as major importing nations enter into recession, leaving less cash to flow into SWFs.

At the same time, many SWFs are under domestic pressure to redeploy their cash to support local markets and “bail out” domestic firms<sup>19</sup>. In addition, the liquidity crunch has required central bank reserve managers to maintain larger cash reserves, so that fewer “excess” reserves are available for investment. Ironically, at the moment when investment by SWFs might be the most welcome, these funds may have the least appetite and ability to invest.

### *ADVANTAGES AND CONCERNS ABOUT SOVEREIGN WEALTH FUND INVESTMENT*

SWFs offer their investee countries and companies at least two very clear advantages: access to capital and mutuality of interests. The primary benefit that recipient nations receive from SWFs investments is increased access to capital. For this reason, most countries at least profess an interest in investment by SWFs. However, access to capital is not the only benefit that recipient countries receive as a result of SWF investment. When SWFs invest in foreign assets, they connect the financial destinies of two national economies. Prosperity is arguably no longer a zero-sum game. As the recipient nation enjoys economic growth, so does the nation that manages the SWF. This could reduce tensions across cultures and encourage more cooperation. Of course, markets do not always go up, and the resulting losses can often increase tension in what had otherwise been a mutually satisfactory relationship.

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At the same time, SWF investment brings with it a number of concerns. From a national security viewpoint, policymakers worry that these funds could use their investments to undermine the national security of the recipient nation. This can be a legitimate concern, but there is also the potential for recipient nations to cite national security concerns that are not legitimate as an excuse to keep out foreign direct investment by other countries.

In the United States, political leaders have generally sought to balance the positive aspects of foreign direct investment with the potential risks that foreign control over US assets may pose to national security. Compared to many industrialized nations, the approach taken by the United States is hospitable to foreign direct investment. For

example, some countries use an investment screening process that automatically subjects all transactions above a certain value threshold or other criteria to a mandatory review by government agencies, whether or not national security concerns are implicated. In contrast, under the Foreign Investment and National Security Act of 2007 (FINSA)<sup>20</sup>, the United States screens foreign acquisitions on the basis of national security concerns. Although filing requirements may apply under other federal or state laws<sup>21</sup>, the United States does not have a general screening process that subjects all large foreign acquisition transactions to a mandatory review.

The principal body responsible for implementing FINSA is the Committee on Foreign Investment in the United States (CFIUS), which is comprised of high-ranking Cabinet members from several government agencies. Final regulations issued by the US Treasury Department effective December 22, 2008 (the “Final Rule”)<sup>22</sup>, and related guidance published on December 8, 2008<sup>23</sup>, expand the scope of national security reviews, codify many of CFIUS’s existing practices and provide increased clarity and transparency regarding the process.

FINSA provides for review by CFIUS of the national security implications of a “covered transaction”<sup>24</sup> if it results in “control”<sup>25</sup> of a US business by a foreign person. The initial review of a covered transaction must be completed within 30 days. Typically, the 30-day review period is commenced after CFIUS receives voluntary notice by the parties to a transaction<sup>26</sup>. Although in the vast majority of cases, CFIUS completes its review within the initial 30-day statutory review period, CFIUS is required to initiate an investigation, which it must complete within a subsequent 45-day period, in the following situations:

- 1 - CFIUS or a member of CFIUS believes that the transaction threatens to impair US national security and that threat has not been mitigated prior to or during the 30-day review;
- 2 - an agency designated by US Treasury as the “lead agency” for the transaction recommends, and CFIUS concurs, that an investigation be undertaken;
- 3 - the transaction is a foreign government-controlled transaction;
- 4 - or the transaction would result in foreign control of any “critical infrastructure” of or within the United States, if CFIUS determines that the transaction could impair national security and that risk has not been mitigated.

With respect to transactions described in (3) and (4) above, CFIUS would not initiate the additional 45-day investigation if the US Treasury Department and any lead agency it has designated determine, at the

Deputy Secretary level or higher, that the transaction will not impair the national security of the United States<sup>27</sup>.

Critics point out that, broadly interpreted, FINSA could be used as a protectionist instrument, obstructing investments by SWFs that do not raise traditional national security concerns. Although the US Treasury's Guidance clarifies that "CFIUS focuses solely on any genuine national security concerns raised by a covered transaction, not on other national interests"<sup>28</sup>, in the past CFIUS has construed "national security" broadly<sup>29</sup>, and President Obama's appointees on CFIUS are likely to continue to do so. Therefore, SWFs should plan their cross-border investments into the US carefully in light of the recent revisions to FINSA and related political ramifications.

Another concern with respect to SWFs is corporate governance. While many policymakers are pleased that foreign entities generally make passive investments, Lawrence Summers, senior economic advisor and director of the US National Economic Council under Obama, expressed concern at Davos that SWFs may entrench poor management. The passivity of a large long-term shareholder could result in poor oversight and make shareholder actions against management difficult to enact. As a result, passive and publicity-shy SWFs could breed ineffective corporate governance practices<sup>30</sup>.

Another significant concern is with respect to the motivation behind SWF investment. Few of these funds plainly state their objectives, and none offer any binding assurances that their investment choices will be made on a commercial rather than a political basis. This has led to widespread speculation over what drives these funds to invest. At Davos, Lawrence Summers expressed concern that SWFs may invest for "multiple motives", i.e. for political or non-economic motives in addition to economic motives<sup>31</sup>. For example, a SWF might invest in an airline with the intent of pressuring that airline to service flights in the SWFs' owner-nation. Alternatively, a fund might take an equity stake in a company to enable it to harvest and extract technology that the owner-nation has been unable to develop on its own. Even more invidiously, a SWF could invest to stifle competition, actively seeking to sabotage the companies it holds so that the owner-nation's flagship industry can dominate international markets.

Capitalist markets operate under the assumption that investments are made in order to maximize value and earn a return. If SWFs are investing large pools of assets for reasons other than earning a profit, equity prices will not reflect value, distortions will appear in the market and inefficiencies will result.

Summers has also expressed concern about "politicization", which is

almost the reverse of the “multiple motives” concern. It assumes that SWFs and the governments that control them invest for the purpose of maximizing returns, but could use their political leverage to prevent losses or generate wealth through their investments<sup>32</sup>. A SWF that invested billions of dollars to acquire a minority stake in a failing bank could theoretically use its diplomatic influence to obtain a bailout for the company. While this may be a legitimate concern, it is also possible that politics could work against a SWF. A bank that a government might otherwise bail out could lose its popular appeal for assistance if the host government disfavors the SWFs’ owner-nation.

Some commentators have expressed concern with the excessive economic and political leverage of these funds. Testifying at an April 24, 2008 Congressional hearing on SWFs, Ethiopis Tafara, Director of the Office of International Affairs at the US Securities and Exchange Commission, noted that if SWFs increase five-fold by the middle of the next decade, as one investment bank had forecast at the time, “that could make these funds, collectively and perhaps individually, the largest shareholders in many of the world’s biggest companies that are today privately owned”<sup>33</sup>. While investment funds in Kuwait, Qatar, Dubai and Abu Dhabi are reportedly shifting assets to support collapsing local markets after losing billions of dollars in Western countries, in November, Sameer al-Ansari, Chief Executive of Dubai International Capital, reportedly remarked “to become the largest shareholders in the ten largest companies in the world would cost about \$50 billion at present and that’s actually not a lot of money... Imagine the power and influence this region would have if we were the shareholders in the ten, twenty, thirty largest companies in the world”<sup>34</sup>.

A number of commentators, including the former Chairman of the US Securities and Exchange Commission, Christopher Cox, have expressed concerns that SWFs lack transparency. Although SWFs must generally disclose their share ownership and certain other information under Section 13 and Section 16 of the US Securities Exchange Act of 1934 (Exchange Act)<sup>35</sup>, Cox suggested in 2007 that additional regulation, including disclosure requirements, might be necessary<sup>36</sup>. It is unclear what position Mary Schapiro, the new Chairman of the US Securities and Exchange Commission, will take regarding SWFs regulation.

Finally, other critics of SWFs have pointed out that many governments have “inside information” not generally available to the public, both with respect to current market conditions and the viability of regulatory proposals. Officials could share this information with SWFs managers, giving them an unfair advantage<sup>37</sup>.



### *THE SANTIAGO PRINCIPLES AND OECD GUIDANCE ON SOVEREIGN WEALTH FUNDS*

Faced with international criticism and potentially protectionist regulations, SWFs have not stood idly by while pundits in recipient nations debate their fate. Representatives from the world's largest SWFs held a series of meetings in 2008 to address the mounting public scrutiny directed at them. Working with the IMF, these SWFs collaborated to publish a set of 24 investment principles intended to guide these funds as they acquire assets abroad. Known collectively as the "Santiago Principles", these guidelines call for more transparency, increased accountability, sound governance policies and firm commitments to investing on economic, rather than political grounds<sup>38</sup>.

Over two dozen nations, including many of the Gulf and Asian countries that have the largest SWFs, claim to support the Principles. If followed, the Principles could make significant strides in addressing the concerns associated with SWFs. However, there are important weaknesses in the Principles - they are voluntary, non-binding and unenforceable. Left without binding assurances from the funds themselves, political leaders in recipient nations could still seek to regulate unilaterally the activities of these funds.

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Although OECD recipient nations have begun working collaboratively to address international concerns about SWFs, the results of their efforts have been limited. Recipient nations recognize the importance of remaining open to international investors but acknowledge that each individual nation has a duty to protect its national security interests. In June 2008, the OECD Ministerial Council adopted the OECD Declaration on SWFs and Recipient Country Policies (the "Declaration")<sup>39</sup>. The Declaration does not prohibit recipient nations from regulating SWFs. Instead, it seeks to establish a framework by insisting that such regulations be transparent and limited to national security interests. Like the Santiago Principles, the Declaration is non-binding and unenforceable. Individual nations could abandon these Principles (and adopt protectionist policies at any time), if they believe it is in their best interests to do so.

### *POLITICAL AND REGULATORY CHALLENGES IN THE UNITED STATES*

SWFs present particular difficulties for any governmental body that would set out to regulate them. First, as sovereign government-owned entities, they present special considerations not present in terms of regulating privately-owned companies. Bilateral and multilateral

government regulations are at stake, questions of sovereign immunity are raised, and the laws or regulations adopted, if not applied on a “one size fits all” basis, raise difficult diplomatic and legal issues. Can the United States have one policy for the China Investment Corporation but another for the Government Pension Fund of Norway?

Second, a major concern with SWFs is lack of transparency in terms of their investment policy and goals. What do they want? Unlike hedge funds or private equity funds, where one of the regulatory concerns is protecting the underlying investors, with SWFs the main regulatory focus is protecting the company and country receiving the investment. Of course, all large, opaque investment funds, whatever their source, raise concerns about concentration of control.

Even though during the Bush administration, the US Treasury Department repeatedly emphasized the positive aspects of foreign direct investment, SWFs attracted a great deal of attention, much of it negative. In 2007, members of Congress expressed alarm when Dubai Ports World proposed acquiring certain US port terminals, and the attention ultimately scuttled the deal. In April 2008, following a series of high profile investments by SWFs in US investment banks, several members of Congress, including Senator Richard Shelby, ranking member of the Senate Committee on Banking, Housing and Urban Affairs, expressed concern that SWFs could buy up most US industries, and that the United States needed to know more about their intentions and objectives. Recently, the deepening financial crisis has made it increasingly clear that many US financial institutions were woefully undercapitalized, and media attention is focused on the economy and losses in the stock market. Although overall this has led to diminished criticisms of SWFs by the media, with the passage of time press coverage and public sentiment could again turn negative.

While still a candidate, President Obama hinted that regulating wealth funds might be necessary. “I am concerned if these SWFs are motivated by more than just market considerations, and that’s obviously a possibility”, Obama told reporters. “If they are buying big chunks of financial institutions and their boards of directors influence how credit flows in this country and they may be swayed by political considerations or foreign policy considerations, I think that is a concern”<sup>40</sup>. Nevertheless, Obama came short of directly calling for new regulations.

Hillary Clinton, at the time a presidential candidate, was far more critical of SWFs, and her new status as Secretary of State could have a profound impact on US foreign policy. “I raised the alarm about SWFs... because this is a new challenge we face... And I just want to be sure that the IMF, the World Bank, the Federal Reserve, our

government, begin to say, look, we've got to have rules here", she said last year<sup>41</sup>.

Hillary Clinton is the highest ranking US official to call for regulating SWFs. "Think about how it will begin to constrain us. You know, you cannot get tough with your banker. You cannot stand up if they have very different interests in the Middle East or in Asia than we do and they basically say, fine, you want us to dump dollars? Do you want us to pull our investments out?"<sup>42</sup>. Of course, Clinton's statements were made before the full impact of the financial crisis on the US economy was understood, and it is possible that as Secretary of State, she will soften her stance.

Although Lawrence Summers expressed several concerns about SWFs at Davos, he also suggested that if these funds were to get together and agree that they would not pursue any national political objective, it "would allay all the fears out there"<sup>43</sup>. Now that many of these funds have adopted the Santiago Principles, it is unclear whether Summers will take a tough stance on these funds in the future.

US politicians frequently cite deregulation as a major factor in the collapse of the global economy. The Democratic Party now controls the White House and has tightened its control on Congress, and has vowed to overhaul regulation of the US financial industry. There is a growing call for regulating hedge funds and private equity funds. While some of the concerns about these types of funds, such as protecting fund investors, are fundamentally different than those concerning SWFs, there are many policy issues in common, including lack of transparency and concentration of control. In that light, it is possible that a comprehensive regulatory package for reforming the US financial industry will include provisions that target SWFs as well. However, even if SWFs are not the immediate focus of Congressional attention, they seem unlikely to escape tighter regulation for long.

SWFs must be prepared for significant policy changes. If these funds do not actively engage in a dialogue with policy makers, they could potentially be left with stricter rules and fewer investment options. SWFs should emphasize in these discussions that protectionist policies adopted during the current financial crisis would have the effect of inhibiting needed investment, which would be detrimental to both SWFs and OECD recipient countries.

## NOTES

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2. Gordon Brown, British Prime Minister, "So many Challenges the Gulf and Britain Must Face Together", *TheNational*, November 1, 2008.
3. Douglas Herbert, "Sarkozy's Economic Axis of Evil", *France 24 Int'l News*, October 22, 2008.
4. Indeed the US Treasury Department's Troubled Asset Relief Program (TARP) has itself been described by economist Ed Yardeni as the world's largest SWF.
5. David Enrich, Robin Sidel and Susanne Craig, "World Rides to Wall Street's Rescue", *The Wall Street Journal*, January 17, 2008.
6. See : keynote speech of Bader al Sa'ad, Managing Director of the Kuwait Investment Authority, at the First Luxembourg Foreign Trade Conference, *Overview on the Kuwait Investment Authority and Issues Related to Sovereign Wealth Funds*, April 9, 2008, stating that "...if a set of principles or codes of conduct are established for sovereign wealth funds, then recipient countries should also have the same set of principles for all pools of capital, including hedge funds, private equity funds, pension funds, savings funds, and other non listed funds. There should be a common and level playing field for all".
7. Robert M. Kimmitt, Deputy Secretary of the US Department of the Treasury, "Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy", *Foreign Aff.*, January/February 2008; US Department of the Treasury, Report to Congress on International Economic and Exchange Rate Policies, Appendix 3 (2007), available at: <http://www.treas.gov/offices/international-affairs/economic-exchange-rates/pdf/2007/Appendix-3.pdf>.
8. See: US Department of the Treasury, Report to Congress on International Economic and Exchange Rate Policies, Appendix 3 (2007), *supra* n° 7. SWFs in China, South Korea and Taiwan are examples of this type of fund. See: "Asset backed insecurity", *The Economist*, January 17, 2008, available at: [http://www.economist.com/opinion/displaystory.cfm?story\\_id=10533428](http://www.economist.com/opinion/displaystory.cfm?story_id=10533428).
9. "Asset Backed Insecurity", *The Economist*, January 17, 2008, *supra* n° 8. See also: "Kuwait Investment Authority", SWF Institute, available at: <http://www.swfinstitute.org/fund/kuwait.php>.
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11. Christina L. Madden, "Sovereign Wealth Funds under Scrutiny", *Policy Innovations*, May 21, 2008.
12. See: "Sovereign Funds: their Role and Significance", Remarks by John Lipsky, First Deputy Managing Director of the International Monetary Fund, Santiago, September 3, 2008, available at: <http://www.imf.org/external/np/speeches/2008/090308.htm>.
13. "Asset Backed Insecurity", *supra* n° 8 (stating that Stephen Jen, an economist at Morgan Stanley, who tracks these funds closely, has "penciled in \$12 trillion for 2015").
14. See: Simon Johnson, "Straight Talk - The Rise of Sovereign Wealth Funds", *Finance & Development*, a quarterly magazine of the International Monetary Fund, vol. 44, n° 3, September 2007, available at: <http://www.imf.org/external/pubs/ft/fandd/2007/09/straight.htm>.
15. See: Stanley Reed, "Sovereign Wealth Funds Taste Bitter Losses", *Business Week*, December 11, 2008, stating that Stephen Jen, an economist at Morgan Stanley, estimates that SWFs have seen declines in of 18% to 25% in their holdings this year.
16. See: Lin Noueihed, "Cash-strapped West Looks to Wary Gulf in Crisis", *Reuters*, November 2, 2008 (citing Eckart Woertz, an economist at Gulf Research Centre, who stated: "Some of these Gulf SWFs are estimated to have over half their portfolios invested in equities which have lost 30% or more... so naturally they are reluctant").
17. See: George Chen, "China's Sovereign Fund Hires Experienced Dealmakers", *Reuters*, December 4, 2008 ("CIC has attracted criticism at home over its investments in US financial institutions which have been battered by the credit crisis, with its stakes in private equity house Blackstone Group... and Morgan Stanley... diving in value").
18. See: Landon Thomas, Jr., "Sovereign Wealth Funds Seek Safety", *Int'l Herald Tribune*, October 12, 2008.
19. See: Stanley Reed, "Sovereign Wealth Funds Taste Bitter Losses", *supra* n° 15, noting that some funds "have come under pressure to use their assets more for domestic purposes than for foreign

investment". See also: Luo Jun, "Central Huijin Spends \$175 Million on Three Banks, Paper Says", *Bloomberg*, December 3, 2008, reporting that Central Huijin Investment Co., a unit of China's SWF, has invested \$175,000,000 in three Chinese banks - Industrial & Commercial Bank of China Ltd., Bank of China Ltd. and China Construction Bank Corp. - to bolster confidence in China's stock market. In December 2008, Qatar's SWF, the Qatar Investment Authority, reportedly invested in various important Qatari financial institutions, including Doha Bank QSC, Qatar's third-biggest bank by assets, Qatar Islamic Bank SAQ and Al Khalij Commercial Bank QSC, to boost their capital levels and support domestic development projects. See: Ari Sharif, "Qatar Islamic Bank to Sell 39.4 Million Shares to Wealth Fund", *Bloomberg*, December 24, 2008; Shaji Mathew, "Doha Bank Shareholders Approve Raising Capital by 20%", *Bloomberg*, December 22, 2008; and Ari Sharif, "Abu Dhabi Commercial Bank, Al Khalij, Zain: Gulf Equity Preview", *Bloomberg*, December 17, 2008.

20. 50 USC App. § 2170; Pub. L. N° 110-49, 121 Stat. 246 (2007). FINSA amends the "Exon-Florio" amendment to the Defense Production Act of 1950, which provides for national security reviews of foreign investments.

21. For example, many SWFs have invested in US financial institutions, which can trigger review by the Federal Reserve Board under the Bank Holding Company Act of 1956 or the Change in Bank Control Act of 1978, depending on the circumstances. Transactions in other sectors, such as telecommunications, defense, airlines, maritime, insurance and utilities, may trigger federal or state requirements. Certain merger or acquisition transactions trigger a notification requirement under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. Foreign persons establishing new US operations or acquiring US companies may also be required to file reports with the US Commerce Department, Bureau of Economic Analysis. A full discussion of the requirements of FINSA and other applicable federal and state laws is beyond the scope of this article, but readers may contact the authors for additional information.

22. The final regulations, *Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons*, 31 CFR Part 800, are available at: [http://www.treasury.gov/offices/international-affairs/cfius/docs/finalregs\\_111408%20.pdf](http://www.treasury.gov/offices/international-affairs/cfius/docs/finalregs_111408%20.pdf). Additional information on CFIUS is available at: <http://www.treasury.gov/offices/international-affairs/cfius/>.

23. See: Department of the Treasury, Office of Investment Security; "Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States", 73 Fed. Reg. 74, 567, December 8, 2008 (the "Guidance").

24. "Covered transactions" include acquisition transactions, including joint-ventures, by or with a foreign person which could result in control of a US business by a foreign person. The term does not include start-up or "greenfield" transactions. Asset acquisitions are not covered if the assets acquired by a foreign person do not constitute a "US business".

25. Under the Final Rule, "control" is defined as the "power, direct or indirect, whether or not exercised... to determine, direct, or decide important matters affecting an entity". CFIUS does not apply a bright-line test to determine whether a transaction results in foreign "control", but considers all relevant facts and circumstances. The Final Rule identifies minority shareholder protections that do not, in themselves, constitute control. The Final Rule clarifies that there is no automatic exclusion based solely on whether an investment is 10% or less in a US business. However, a foreign person will not be deemed to "control" an entity if it holds 10% or less of the voting interest in the entity and it holds that interest "solely for the purpose of passive investment".

26. Parties to a transaction that could present national security considerations have a strong incentive to file a voluntary notice with CFIUS because a covered transaction that has been reviewed by CFIUS, and as to which CFIUS concludes there are no unresolved national security concerns, qualifies for a "safe harbor". Without the benefit of this safe harbor, CFIUS has authority to initiate review of a transaction even after it closes if it determines that national security concerns are implicated.

27. See: "The Guidance", *supra* n° 23, at 74,568.

28. 73 Fed. Reg. 74,568.

29. The term "national security" is not defined in the statute or regulations, other than to note that the term includes issues related to homeland security. However, the statute lists a number of factors that are to be considered by CFIUS and the President in determining whether a transaction poses a national security risk, including whether a transaction would result in control of "critical infrastructure" that could impair national security, or would result in foreign government control of a US entity.

30. See: Remarks by Lawrence Summers at the World Economic Forum held in Davos, Switzerland, January 24, 2008, video available at: <http://sovereignwealthfunds.wordpress.com/2008/01/27/sovereign-wealth-funds-%E2%80%98%E2%80%99-topic-at-2008-world-economic-forum>. See also: Daniel Gross, "SWFs Seek Acceptance in US", *Newsweek*, January 24, 2008.
31. See: Remarks by Lawrence Summers at the World Economic Forum held in Davos, Switzerland, January 24, 2008, *supra* n° 30. See also: Daniel Gross, "SWFs Seek Acceptance in US", *supra* n° 30.
32. See: *id.*
33. See: Ethiopis Tafara, Director, Office of International Affairs, US Securities and Exchange Commission, "Testimony Concerning the Regulatory Framework for Sovereign Investments", before the Committee on Banking, Housing and Urban Affairs, United States Senate (April 24, 2008).
34. See: David Robertson, "Sovereign Wealth Funds Switch from Western Investments", *The Times Online*, November 26, 2008, available at: [http://business.timesonline.co.uk/tol/business/industry\\_sectors/banking\\_and\\_finance/article5233278.ece](http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article5233278.ece).
35. Beneficial ownership of more than 5% of a class of equity securities registered under the Exchange Act must generally be disclosed on Schedule 13D or 13G, as applicable. Institutional investment managers who exercise investment discretion over \$100 million or more of SEC-registered securities file reports on Schedule 13F on a quarterly basis reporting on all SEC-registered securities in their accounts. Under Section 16 of the Exchange Act, an owner of more than 10% of a registered class of equity securities of a US domestic company must file a statement of ownership regarding its position and changes to its position.
36. See: Remarks of the Chairman of the US Securities and Exchange Commission, "The Rise of Sovereign Business", Gauer Distinguished Lecture in Law and Policy at the American Enterprise Institute Legal Center for the Public Interest, December 5, 2007. Although Chairman Cox's remarks were made prior to the adoption of the Santiago Principles (discussed herein), Edwin Truman, a leading commentator on SWF best practices, has written that "...disturbingly, many of the principles are silent about disclosure to the general public or only call for disclosure to the fund's owner. That approach does not promote the needed accountability to citizens of the country with the SWF or of other countries. As we knew would be the case, the IWG punts on each fund's revealing its size even while endorsing full annual reports where that information would be redacted". See: Edwin M. Truman, "Making the World Safe for Sovereign Wealth Funds", Peterson Institute for Int'l Economics, October 14, 2008, available at: <http://www.petersoninstitute.org/realtime/?p=105>.
37. See: Linda Chatman Thomsen, Director, Division of Enforcement, US Securities and Exchange Commission, *Testimony Concerning Sovereign Wealth Funds and Public Disclosure*, Before the US-China Economic and Security Review Commission, Feb. 7, 2008, available at: <http://www.sec.gov/news/testimony/2008/ts020708lct.htm>.
38. See: *Sovereign Wealth Funds Generally Accepted Principles and Practices*, "Santiago Principles", International Working Group of Sovereign Wealth Funds, October 2008, available at: <http://www.iwg-swfs.org/pubs/eng/santiagoprinciples.pdf>.
39. The Declaration, endorsed by Ministers from 33 recipient nations, espouses two key principles. First, recipient nations should remain open to foreign investment from SWFs and avoid taking protectionist actions. Only legitimate national security concerns should restrict foreign investments. Second, recipient countries should not "discriminate against investors in like circumstances" i.e., to the extent possible, SWFs should be governed by policies generally applicable to foreign and domestic investors. See: "OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies", Organisation for Economic Cooperation and Development, June 5, 2008, available at: <http://www.oecd.org/dataoecd/18/14/41816692.pdf>. See also: "OECD Guidance on Sovereign Wealth Funds", available at: [http://www.oecd.org/document/19/0,3343,en\\_2649\\_34887\\_41807059\\_1\\_1\\_1\\_34529562,00.html](http://www.oecd.org/document/19/0,3343,en_2649_34887_41807059_1_1_1_34529562,00.html).
40. "Obama says concerned about sovereign wealth funds", *Reuters*, February 7, 2008.
41. Remarks of Hillary Clinton in an interview with Peter Cook on Bloomberg Television, January 16, 2008, available at: [http://www.realclearpolitics.com/articles/2008/01/clinton\\_on\\_bloomberg\\_televisio.html](http://www.realclearpolitics.com/articles/2008/01/clinton_on_bloomberg_televisio.html).
42. See: *id.*
43. See: Larry Summers, "Sovereign Wealth Funds Should Agree to Standards to Allay Fears", *New Perspectives Quarterly*, vol. 25, n° 4, January 25, 2008, available at: [http://www.digitalnpg.org/articles/economic/238/01-25-2008/larry\\_summers](http://www.digitalnpg.org/articles/economic/238/01-25-2008/larry_summers).