ATTACK OF THE SOVEREIGN WEALTH FUNDS: DEFENDING THE REPUBLIC FROM THE THREAT OF SOVEREIGN WEALTH FUNDS?

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THE WHITE HOUSE
Office of the Press Secretary

FOR IMMEDIATE RELEASE

WASHINGTON — Today, President Mercedes Chávez announced that Americans will now be required to spend one day a week without electrical power. Details of the implementation of the new “conservation blackouts” will be released tomorrow. Conservation blackouts will be imposed across the United States, roughly corresponding to the geographic outlines of our time zones. Hawaii will be included in the Mountain Time Zone; Alaska will be blacked out during the same times as the Eastern Time Zone.

This latest step toward a greener America has become necessary because last evening the Board of Directors of Exxon Corporation unanimously voted to divert all hydrocarbons it produces outside the United States to the still booming Chinese market. After the board meeting, the Exxon directors, who for the past two years have been nominated and elected by the three sovereign wealth funds that together own 75.5% of Exxon’s outstanding voting stock, telephoned the President informing her, “as a courtesy,” that they “had reluctantly and with regret” determined that this decision was in the best interests of Exxon and its shareholders. They stated that the expanding Chinese economy, which has grown at more than 9% in each of the past fourteen years, would obviously be able to make substantially more productive use of Exxon’s crude oil and natural gas than the U.S. economy, mired as it has been, in the Great Recession which dates from 2007.

As we know, in 2010 and 2011, the escalation of fuel prices added trillions of additional dollars to the sovereign wealth funds of a number of foreign nations. Beginning in late 2011, in strict compliance with the Federal Emergency Public Company Relief Act of 2011 (“EPCRA 2011”), controlling interests in many of America’s largest corporations were purchased by the sovereign wealth funds of Singapore, China, and four of the United Arab Emirates. Their two-year buying spree in 2011 and 2012 resulted in what President Chávez referred to in her election campaign as the “extra-nationalization” of most major U.S. corporations. To
“recycle” their huge dollar surpluses these sovereign wealth funds purchased controlling interests in eighty-eight of the corporations constituting the “Fortune 100.” Once control of these companies had been transferred offshore, the primary focus of each of these corporations became support for the expanding consumer markets of Asia and Latin America. This redirection of corporate purposes was in accord with Restated Santiago Principle 25, adopted by the sovereign wealth funds making up the International Working Group (“IWG”) Principle 25 of the IWG’s Generally Accepted Principles and Practices (“GAPP”) had been announced by the IWG in August, 2011. GAPP 25 conditions the rescue of America’s struggling corporate giants by these sovereign wealth funds on prior agreement by the U.S. Congress and the Administration’s Committee on Foreign Investment in the United States (“CFIUS”) to the realignment of the primary business focus of the rescued companies to the vibrant, expanding economies of China and Latin America. The reorientation of the business purposes of the rescued companies required by GAPP 25 was explicitly mandated in EPCRA 2011.

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“In a separate announcement today, President Chávez also lauded the performance of America’s new Smartmatique voting machines in the recent mid-term election which gave her the support of an unprecedented 68.7% of the House of Representatives and 70% of the Senate. The President also thanked her husband, Venezuela’s Great Leader and President for Life, Hugo Chávez, for sending 1900 Venezuelan technicians on very short notice to clear up what at first had appeared to be a major technical flaw in the nation’s electronic voting machines.”

I. THE THREAT FROM SOVEREIGN WEALTH FUNDS

The foregoing scenario is ridiculous, is it not? Given the current state of hysteria, hyperbole, and utter nonsense in current American political discourse, there may be those who assert that this is the fate we face from the threat of sovereign wealth funds (“SWFs”).

Some believe SWFs have already begun to take over the world. A headline in the Christian Science Monitor asks, Will Sovereign Wealth Funds Rule the World? The New York Times picked up this theme in an editorial headlined, Who Will Come to the Rescue? In the popular press,

1. This term was first used in 2009 by Douglas Koenig, a law student in my Strategic International Transactions Seminar, to describe companies headquartered in one country but under constructive control of a different sovereign.
2. See infra note 126.
3. Please note, the above scenario is entirely hypothetical.
Robert Samuelson, a respected columnist for Newsweek magazine, refers to China’s predatory trade practices, feeding the fear that China’s investment practices may also be predatory. The International Herald Tribune described concern in the European Union in an article entitled, Europe Looks to Control State-Run Investors: Officials Wary of Intentions of China and Russia.

Candidates for political office have also chimed in. In a debate during her campaign to become the Democratic Party’s nominee for President in 2008, Senator Hillary Clinton declared, “[w]e need to have a lot more control over what [sovereign wealth funds] do and how they do it.”

Professors Milhaupt and Gilson, stars of the corporate governance academy, have characterized the issue as one of “state capitalism as opposed to market capitalism” and proposed that shares of U.S. companies in the hands of foreign states should lose their votes while so held.

Even Hollywood has picked up this theme. A recent James Bond adventure takes on the global struggle for oil in “The World Is Not Enough.” Perhaps the world is not enough, but Bond’s title song reveals that it is a “perfect place to start.”

This Article presents the background of the current SWF phenomenon and considers the supposed threat posed when SWFs either acquire outright ownership of U.S. companies or accumulate significant equity ownership stakes.

Part II of this Article reviews the evolution and development of SWFs from their first appearance in the mid-twentieth century to the economic crisis of 2007–2009. SWFs have been established by more than fifty nations and subdivisions thereof with excess dollars and other foreign currencies generated either by sales of oil and natural gas and other commodities or by well-managed balance of trade regimes. In particular, Part II analyzes (i) the explosive growth of assets under management by SWFs since 2004; (ii) their recent rise to prominence in public political debate; and (iii) the outsized investments in major financial institutions that

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10. THE WORLD IS NOT ENOUGH (MGM Studios 1999).
12. See infra, part II.A, for a discussion of various definitions of this term.
13. The descriptor “well managed” is required because there are economies where more than every available dollar is spent. The United States is only one such example.
were once referred to as the “commanding heights” of the economy, as an important example of the role SWFs will have in the future.

Part III of this Article briefly summarizes America’s long history of regulation of investments by foreigners. Beginning with protections originating in the early nineteenth century, Part III highlights the efforts to regulate foreign investment, including the Congressional response to the threat posed by SWFs, manifested in the July 2007 enactment of the Foreign Investment and National Security Act (“FINSA”). Part III further outlines the impact of FINSA on the administration of governmental reviews of foreign investments by the Committee on Foreign Investment in the United States (“CFIUS”), an entity within the Executive Branch.

Part IV of this Article considers recent actions taken by the leading SWFs through the IWG to address concerns raised by the Organisation for Economic Cooperation and Development (“OECD”), whose member countries have enjoyed large SWF investments. The IWG published its Generally Accepted Principles and Practices (“GAPP”) in October, 2008. The GAPP starkly demonstrates my principal assertion: SWFs will not, and cannot be expected to, make commitments that will satisfy those who fear the consequences of investments by such funds. The suggestion that principles or practices, such as those included in GAPP, could be implemented in a way that would alleviate such fears is at best self-deluding. At worst it is a cynical political ploy. Indeed, such commitments are impossible for any category of investor. To pretend that SWFs, created by and ultimately responsible to sovereign nations, will make meaningful, binding commitments not to act in their own best interests, is absurd on its face. What has been suggested as “protection” for investee states would not be agreed to by private investors and is a complete non-starter for SWFs.

Part V of this Article details the behavior of a few of the very largest SWFs since the extent of the current economic crisis became apparent. It

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14. The term goes back three quarters of a century. . . . Lenin had initiated the New Economic Policy, permitting a resumption of small trade and private agriculture. Now, communist militants were attacking him for compromising with capitalism and selling out the revolution. . . . Lenin defended the program. Although the policy allowed markets to function, he declared, the state would control the “commanding heights,” the most important elements of the economy.


16. See infra, note 115.

is instructive to consider how SWFs have acted because many of the tens of billions of dollars they invested in the world’s leading financial institutions in 2007 and 2008 vanished in 2008 with the demise of Bear Stearns, Lehman Brothers, AIG, and others. How the SWFs behaved once the enormity of the financial black hole that the crisis spawned became apparent is an indicator of the threat they pose.

Part VI of this Article concludes with an appraisal of the behavior of SWFs in the crisis and what is to be learned concerning the threat SWFs pose.

II. THE EVOLUTION AND DEVELOPMENT OF SOVEREIGN WEALTH FUNDS

A. What is a Sovereign Wealth Fund?

The key characteristic of a SWF is its ownership and control by a sovereign government. There are a wide variety of definitions of a SWF. The U.S. Treasury Department defines SWFs as “a government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities.” Deutsche Bank, a leading financial institution that follows SWFs exhaustively, defines SWFs as “government-owned investment funds which are commonly funded by the transfer of foreign exchange assets, and which are set up to serve [their] objectives . . . by investing the funds on a long-term basis, often overseas.” The Sovereign Wealth Fund Institute (“SWF Institute”) describes a SWF as “a state-owned investment fund composed of financial assets such as stocks, bonds, real estate, or other financial instruments funded by foreign exchange assets.”

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18. “Sovereign” when used herein includes individual states of the United States, such as Alaska, and individual emirates within the United Arab Emirates, such as Abu Dhabi.
The Monitor Company Group Ltd ("Monitor") - Fondazione Eni Enrico Mattei ("FEEM"), a joint research project that focuses on SWFs, defines SWFs narrowly so as to only include seventeen in their list of SWFs.\footnote{Monitor and FEEM define a SWF on the basis of the essential characteristics that differentiate them from other government-owned investment vehicles. Specifically, a SWF must meet the following five criteria:
1. It is owned directly by a sovereign government;
2. It is managed independently of other state financial institutions;
3. It does not have predominant explicit pension obligations;
4. It invests in a diverse set of financial asset classes in pursuit of commercial returns; and
5. It has made a significant proportion of its publicly-reported investments internationally.

A Government Accountability Office ("GAO") study entitled "Report on Foreign Investments" defines SWFs based upon their "outside" focus and provides a four-element test for government policymakers.\footnote{The GAO] classified SWFs with the most interest to policymakers as those that (1) are government-chartered or sponsored investment vehicles; (2) invest some or all of their funds in assets other than sovereign debt outside the country that established them; (3) are funded through government transfers arising primarily from sovereign budget surpluses, trade surpluses, central bank currency reserves, or revenues from the commodity wealth of a country; and (4) are not actively functioning as a pension fund (money received from individuals). U.S. Gov't Accountability Office [GAO], Sovereign Wealth Funds: Laws Limiting Foreign Investment Affect Certain U.S. Assets and Agencies Have Various Enforcement Processes, GAO-09-608, at 5 (2009).}

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There are at least fifty-two funds that fall within the SWF Institute’s broad definition.\footnote{See infra App. A.}

Each of the ten largest SWFs has assets exceeding $500 billion.\footnote{SWF Rankings, supra note 21 (noting Kiribati, Mauritania, and Indonesia rankings).}

The smallest SWFs hold less half a billion dollars.\footnote{The ten largest SWFs are Abu Dhabi Investment Authority, Saudi Arabian Monetary Authority ("SAMA"), Norway’s Government Pension Fund —Global, China’s State Agency for Foreign Exchange ("SAFE"), China Investment Corporation, Government of Singapore Investment Corporation, Kuwait Investment Authority, Hong Kong Monetary Authority Investment Portfolio, Russia’s National Welfare Fund, and Singapore’s Temasek Holdings. SWF Rankings, supra note 21. The extreme size range of SWF assets becomes clear when we compare the $550 million Kiribati fund with the Abu Dhabi fund, which is more than1000 times larger. Id.}
B. When Did Sovereign Wealth Funds Appear?

The first of what we now label SWFs appeared in 1953. The first SWFs were referred to by terms descriptive of their purpose or origin, such as “revenue equalization reserve funds,” “stabilization funds,” or simply “investment funds.” This Article uses the accepted term, “sovereign wealth fund,” coined in 2005 by Andrew Rozanov at State Street Global Markets.

Only fourteen SWFs existed prior to 1990. The first three SWFs were established prior to 1967. Following those, five were established during the 1970s; six were established in the 1980s; eight were established in the 1990s; ten were established during the five years beginning with 2000 and ending in 2004; and nineteen were established after 2004. However, the date the Saudi Arabian Monetary Authority began to act as a SWF is unknown.

Thirty of these SWFs are funded with proceeds from the export of crude oil or natural gas. Given the great commodity and consumer debt bubbles of the first decade of the twenty-first century, bubbles that took the price of crude oil from below $20 per barrel in the late 1990s to above $140 in 2007, it is not a surprise that many SWFs are funded through the sale of crude oil and other commodities. The commodity and debt bubbles also help explain why nineteen SWFs have been established since 2004. Ten of the SWFs established in the twenty-first century are funded, not by

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27. “The Revenue Equalization Reserve Fund, a trust fund financed by phosphate earnings over the years, is still an important part of the government’s assets and contained more than [ ] $554 million in 2006. Kiribati has prudently managed the reserve fund, which is vital for the long-term welfare of the country.” U.S. Department of State, Background Note: Kiribati, (May 2009), http://www.state.gov/r/pa/ei/bgn/1836.htm.


29. For example, in 1953, the Kuwait Investment Board began and now maintains the Kuwaiti Future Generation Fund, and the Iran Oil Stabilisation fund was established in 1999. See SWF Institute, supra note 21.

30. Lee Hudson Teslik, Backgrounder on Sovereign Wealth Funds, COUNCIL ON FOREIGN REL., Jan. 28, 2009, http://www.cfr.org/publication/15251/ (“SWFs can invest in whatever they want, just as if they were independent investment funds.”).


32. SWF Rankings, supra note 21; see infra App. A.

33. SWF Rankings, supra note 21; see infra App. A.

34. SWF Rankings, supra note 21; see infra App. A.

35. SWF Rankings, supra note 21 (“The . . . Saudi Arabian Monetary Agency (“SAMA”), was established as the central bank of the Kingdom of Saudi Arabia in 1952 to handle growing foreign reserve funds.”).

36. Id.

37. See infra Chart 3.
commodity exports, but by balance of trade surpluses, derived in part from the excessive debt that the United States and other consumers incurred and spent in this period.

C. Why Were Sovereign Wealth Funds Established?

Each SWF has unique objectives. Since we are dealing with entities controlled by sovereign governments, their investment philosophies and goals need not be disclosed. They may also be changed or ignored at any time. Nevertheless, SWFs often publish investment goals, and there are likely purposes or goals which are common to SWFs. These goals include investing to:

- Diversify away from non-renewable commodities;
- Increase the return on national savings;
- Directly implement domestic economic development objectives;
- Invest currently unneeded dollar liquidity; and
- Achieve long-term returns which preserve and enhance international purchasing power of national assets.

D. Why Is the Spotlight Now on Sovereign Wealth Funds?

SWFs have been extensively covered in the news since 2006. Some SWFs have existed for decades and have been quietly, and not entirely secretly, investing internationally. For example, it is known that Temasek, a SWF established by Singapore in 1974, has long held major interests in regional entities such as Singapore Airlines and SingTel. But Temasek and other early SWFs also invested internationally for decades without attracting adverse attention. This Section explores the changes in the economic milieu and in the SWFs themselves that raised the profile of SWFs.

The current high profile of SWFs is not explained by their size. Compared to other large investors, SWFs are relatively insignificant.

38. See infra App. A.
39. For example, SWFs from Iran, Kazakhstan, Qatar, and Kuwait share this stated goal. See id.
40. For example, SWFs from Alaska and Botswana share this goal. See id.
41. One such example is Vietnam’s SWF. See id.
42. For example, SAFE and the State General Reserve Fund of Oman share this goal. See id.
43. For example, SWFs from Azerbaijan, Brazil, Norway, China (CIC), and Abu Dhabi (Mubadala) share this goal. See id.
44. “SingTel is the largest company listed on the Singapore Exchange with a market capitalization of more than SS40 billion.” See SingTel, Company Profile, http://home.singtel.com/about_singtel/company_profile/default.asp (last visited Nov. 4, 2009).
Table 1 reveals that while SWFs have some $3.8 trillion in assets under management, pension funds worldwide have an estimated $19 trillion of assets under management. Insurance companies have approximately $21 trillion in investable assets, and investment funds of all sorts manage an estimated $22 trillion.

Notwithstanding the comparatively insignificant size of investable funds controlled by SWFs, their sudden appearance in the equity markets and the massive size of their individual investment positions has triggered concerns in both the popular media and in the U.S. Congress. The unique characteristic of a SWF investment is that it is controlled by a sovereign whose true present and future investment intentions are unknown and unknowable. The economic, diplomatic, and political interests of a sovereign will almost always coincide with the goals of a SWF, but they need not always do so. At times, diplomatic or political interests could trump traditional investment goals. This lack of knowledge makes it possible for Congress and the media to see SWFs as a threat.

In principle, SWF investments should be managed with a multi-year horizon, with investments made for the long term, and with the goal of wealth maximization within the fund. To date there is no evidence to suggest that any SWF, no matter how opaque its operations, has acted in any instance for political or diplomatic, or non-economic, purposes.

Table 1

<table>
<thead>
<tr>
<th>Hedge Funds</th>
<th>$ 1.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>SWFs</td>
<td>$ 3.8</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>$ 19</td>
</tr>
<tr>
<td>Insurance Co.</td>
<td>$ 21</td>
</tr>
<tr>
<td>Mutual funds</td>
<td>$ 22</td>
</tr>
<tr>
<td>Global GDP</td>
<td>$ 61</td>
</tr>
</tbody>
</table>

*(in trillions of U.S. dollars)*

Table 1 is used with authorization from its Author. The figure for SWFs has been updated with information from the SWF Institute to reflect SWF assets estimated as of August 2009. See infra App A.

45. Steffen Kern, *Sovereign Wealth Funds: State Investments During the Financial Crisis*, DEUTSCHE BANK RES., July 15, 2009, at 1, 5, available at [http://www.dbresearch.com/PROD/DBR_INTERNET_DE-PROD/PROD00000000000244283.pdf](http://www.dbresearch.com/PROD/DBR_INTERNET_DE-PROD/PROD00000000000244283.pdf). Table 1 is used with authorization from its Author. The figure for SWFs has been updated with information from the SWF Institute to reflect SWF assets estimated as of August 2009. See infra App A.

Nearly every publicly-held enterprise welcomes passive long-term investors. Any large investor could threaten an unwelcome change of control. Typically this threat is a private matter between these parties and of little interest to the government or the public. With SWFs, however, the question is not simply whether the SWF is interested in gaining control of an entity, but whether such an investor might one day use its influence or outright control over an investee company to further the diplomatic policies or political interests of the sovereign. After all, SWFs do not answer to or seek investment funds from other investors. SWFs are ultimately responsible to a sovereign with political and other interests.

Although lack of enforceable transparency rules makes this point impossible to determine, SWFs traditionally sought to protect their cash surpluses by investing in risk-free U.S. Treasury instruments. Treasury bonds, bills, and notes, together with U.S. agency instruments, provided the ultimate in financial security and stability for offshore and domestic holders of the U.S. dollar. When a SWF invests in debt or equity instruments issued by private or public companies, there is seldom an obligation for them to disclose such investments. This is not a unique or threatening feature of funds controlled by a foreign sovereign. It is also the status of private investors.

We can better understand the sudden, recent rise to media and political prominence of the SWFs when we consider three factors: (i) the rapid growth of SWFs in the twenty-first century; (ii) the marked increased in their publicly disclosed investments since 2004; and (iii) the low returns available on U.S. Treasury and agency instruments over the last few years. Two recently aborted investments focused public attention on SWFs. These affairs also contributed to the notoriety SWFs now have.

Chart 1 below, prepared by Steffen Kern at Deutsche Bank Research, illustrates the phenomenal rise of SWF investments after 2003. Because there are no mandatory disclosure rules applicable to SWFs, the data utilized in this chart reflects only that small portion of SWF investments that has become public. The lack of transparency of SWFs generally is not limited to investments made or portfolio holdings. This absence of verifiable data on SWFs as a category is complete. It applies to the overall size of SWFs, portfolio allocations, their individual investment goals and philosophies, historical investment performance, as well as other categories.

47. *See infra* note 51.
48. *See infra* text following note 66.
49. One of the more transparent SWFs is the Government of Singapore Investment Corporation Pte Ltd (“GIC”). Its policy on disclosures is set forth in its *first* annual report, issued in 2008, *twenty-seven years after it was created.* “As the Government of Singapore is the owner of the funds that GIC manages, we take our lead from the Government regarding the disclosure of any information on the funds.” *Gov’t of Sing. Inv. Corp., 2008 Summary Annual Report* 6 (2008).
Nevertheless, Chart 1 starkly reveals another cause of the current focus on SWFs.

Chart 1 reveals that from 1995 through 2003, known SWF investments aggregated about $10 billion. Throughout this early period there are only two years when these investments exceeded $1 billion. In 1999, it is estimated that a total of $2 billion was invested by SWFs; in 2001, this estimate is $4 billion. Dramatic changes appear after 2003, as SWFs accumulated more assets and sought higher returns than those offered by U.S. treasuries and related instruments. During 2004, the aggregate of all known investments made by SWFs grew to $8 billion. These investments jumped to $19 billion in 2005, $35 billion in 2006, $44 billion in 2007, and

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50. Kern, supra note 45, at 13 (indicating that the information presented in Chart 1 is based upon transactions occurring between 1995 and 2009 as reported by Dealogic involving at least one state-sponsored investor on the acquirer side. The reported transactions are likely to entail only a fraction of the transaction de facto undertaken by such vehicles, many of which are not publically disclosed. The data presented here should, therefore, be understood as tentative indicators of broad trends). Chart 1 is reprinted with the permission of its Author.
$58 billion in 2008. This explosive growth explains, in part, the significantly higher profile SWFs now have.

E. Explaining the Explosion in Disclosed Sovereign Wealth Fund Investments

Two contributing factors explain this increase in disclosed investments: (i) the unprecedentedly low rates of return offered by U.S. Treasury and related instruments and (ii) the rapid accumulation of assets under management by the SWFs. Until recently the typical investment for excess dollar holdings of foreign nations was the safest and most secure investments available: U.S. Treasuries or other instruments, such as those issued by the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”), and certain other government supported enterprises (“GSEs”).51 The U.S. Federal Reserve Board’s Open Market Committee (colloquially referred to as the “Fed”) manages certain short term interest rates applicable to commercial banks. The Fed sets the “discount rate,”52 the benchmark for many other market-based interest rates in the United States. This discount rate was lowered to combat the recession of 2001, and was then maintained by the Fed at unusually low levels for several years as Chart 2 reveals.53 The


discount rate was later set even lower as the Fed battled the economic crisis in 2008.

These low Fed discount rates, in turn, meant that the investment return on U.S. Treasury and related obligations was unusually low. Such low returns logically led SWFs to seek for higher returns elsewhere. Higher returns were available in equity interests in Western companies. The chosen companies had to be large to absorb the SWFs’ large investments and thus were likely to have a high public profile.

A second factor contributing to the post-2003 investment surge shown in Table 1 was a large increase in commodity prices. Chart 3 illustrates the remarkable rise in the price of crude oil, which accounts for most of the commodity funded SWFs. In the ten years from 1998 to 2007, crude oil benchmark prices rose from less than $20 to more than $140 per barrel. 56

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54. Id.
55. See infra Chart 3.
56. These prices are specifically for barrels of West Texas Intermediate (WTI) at Cushing.
There was no apparent end to this trend of rising crude oil prices in 2006. With projections into the future of many more trillions soon to be held by SWFs, headline writers, movie producers, and other commercially-motivated individuals announced that SWFs would shortly “own the world!”

There is no consensus view of the total value of SWF assets. Different estimates arise from the varying definitions of SWFs and the lack of transparency of most of these funds. The International Monetary Fund (“IMF”) estimated that SWFs’ controlled assets valued at $500 billion in 1990. SWF assets doubled to $1 trillion by 2005. In mid-2009, the SWF Institute estimated that the fifty-two funds it follows controlled assets valued at $3.8 trillion. It was in this context that the commodity exporting nations and Asian nations with large balance of trade surpluses

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59. Supra notes 4–10.
60. See infra discussion in Part IV, The Santiago Principles.
62. Id.
63. See infra App. A.
64. Korea, Singapore, Japan, and China are some of those among the Asian nations with trade balances. China was estimated to be increasing its foreign currency reserves by
sought to increase the historically low returns on U.S. Treasuries and related instruments.\textsuperscript{65}

1. High Profile Investments

Public awareness of SWFs was also enhanced by two proposed transactions that developed into center-ring attractions in media circuses.

The first was a transaction involving the Chinese National Offshore Oil Company ("CNOOC") which hit the news in June 2005. CNOOC is not a SWF, but the Chinese government owns 70% of it, and CNOOC is therefore referred to as a state-owned enterprise ("SOE"). This ownership by China is sufficient to perfect the analogy to a formal SWF and to the threat, if any, posed by SWFs.\textsuperscript{66}

Within weeks of the resolution of the CNOOC affair, a second controversial transaction became public. Dubai Ports World ("DPW"), a subsidiary of a SWF based in Dubai, stumbled into an inexplicable political fight, best explained by the weakness of the Executive Branch and "the exigencies of the electoral calendar,"\textsuperscript{67} rather than the substance of what Congress claimed to have discovered. When the DPW affair subsided in the spring of 2006, crude oil prices were still steadily climbing and the supposed threat to the American way of life posed by these large accumulations of U.S. dollars in the hands of foreigners was a common theme heard by anyone exposed to the media.

2. CNOOC — Unocal — Chevron

In 2005, CNOOC made an $18.5 billion offer for Unocal, a California-based oil company.\textsuperscript{68} This offer to Unocal stockholders trumped an outstanding $16 billion offer from Chevron Oil Company, also based in California. The CNOOC bid enlivened politics and consumed the media for weeks during the summer of 2005.

The New York Times reported: "The offer is . . . the latest symbol of China’s growing economic power and of the soaring ambitions of its corporate giants, particularly when it comes to the energy resources it needs

\textsuperscript{65} See supra text accompanying note 47.

\textsuperscript{66} As one commentator has noted, in the end CNOOC is controlled by the Chinese Communist Party. Jason Buhi, Negocio de China: Building upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation, 39 H. K. L. J. 197, 202 (2009).

\textsuperscript{67} O’Brien, supra note 50, at 1236.

\textsuperscript{68} Unocal was founded in 1890 as the Union Oil Company of California.
desperately to continue feeding its rapid growth."^{69} CNOOC said its offer represents a premium of about $1.5 billion over the value of Unocal’s deal with Chevron after a $500 million breakup fee.^{70}

The New York Times also reported that “Two Republican representatives from California, Richard W. Pombo and Duncan Hunter, wrote a letter last week to President Bush urging that the transaction be scrutinized on the grounds of national security.”^{71} The California politicians noted in their letter to President Bush:

As the world energy landscape shifts, we believe that it is critical to understand the implications for American interests and most especially, the threat posed by China’s governmental pursuit of world energy resources. The United States increasingly needs to view meeting its energy requirements within the context of our foreign policy, national security and economic security agenda.^{72}

Reacting to the intensive media attention generated by its bid, CNOOC promptly pledged to continue Unocal’s practice of selling all of the oil and gas Unocal produced in the United States to customers in the United States.^{73}

Facing a U.S. domestic political furor fed by Chevron lobbyists in Washington and its public relations firms, CNOOC ultimately withdrew its bid and issued the following statement: “The unprecedented political opposition . . . was regrettable and unjustified . . . . This political environment has made it very difficult for us to accurately assess our chance of success, creating a level of uncertainty that presents an unacceptable risk to our ability to secure this transaction.”^{74} Once the CNOOC threat had

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70. Id.

A fee paid if a party voluntarily backs out of a deal to sell or purchase a business or a business's assets. Termination fees are usually negotiated and agreed on as part of corporate merger or acquisition negotiations. The fee is designed to protect the prospective buyer and to deter the target corporation from entertaining bids from other parties.

BLACK’S LAW DICTIONARY 215, 1609 (8th ed. 2004) (directing readers to the definition of "termination fee" in order to define "break-up fee").

71. Barboza & Sorkin, supra note 69.
72. Id.
73. Id.
been dealt with, Chevron completed its acquisition of Unocal, raising its bid slightly.\footnote{People’s Daily Online, Unocal Reject CNOOC After Chevron Raises Takeover Offer, July 21, 2005, http://english.peopledaily.com.cn/20050721/eng20050721_197449.html. Chevron raised its offer from $16.5 billion to $17.1 billion, or $63 dollars per share in cash and stock, and increased the cash portion to 40% from 25%. \textit{Id.} Unocal’s board voted to accept Chevron’s sweetened offer, and rejected a still higher all-cash offer from CNOOC worth $67 dollars per share. \textit{Id.} While CNOOC’s offer was higher than Chevron’s, the Unocal Board of Directors recommended the Chevron transaction which was approved by shareholders. \textit{Id.}}

3. **Dubai Ports World**

Just a few months after the CNOOC threat to the American way of life was eliminated in August 2005, another foreign threat appeared. Temasek, a Singapore SWF, sought to buy the British ports operator, Peninsular and Oriental Steam Navigation Company (“P&O”). Its offer for P&O, which managed ports in eighteen countries, including six major East coast ports in the United States,\footnote{Those six major East Coast ports are New York, New Jersey, Philadelphia, Baltimore, New Orleans, and Miami. Press Release, Rosa L. DeLauro, Rep., U.S. House of Representatives, DeLauro Co-Sponsors Legislation to Halt Dubai Port Deal (Feb. 22, 2006), http://delauro.house.gov/release.cfm?id=1212.} was ultimately topped by a bid from DPW. Once Temasek withdrew from the bidding,\footnote{Rival Bows out of P&O Battle, BBC NEWS, Feb. 10, 2006, http://news.bbc.co.uk/2/hi/business/4700144.stm.} DPW voluntarily notified CFIUS\footnote{See infra Part II, CFIUS procedures.} that it would acquire P&O. As is detailed in Part III of this Article, the CFIUS process includes an initial thirty day review that is followed by a more exhaustive forty-five day investigation if national security issues are raised.\footnote{See infra Part III text accompanying notes 137, 139.}

DPW fully briefed representatives of all of the CFIUS Executive Branch agencies, including the Department of Homeland Security and interested national intelligence and law enforcement agencies. Following the initial review, CFIUS approved DPW’s acquisition of P&O.\footnote{Patrick McGeehan, Despite Fears, A Dubai Company Will Help Run Ports In New York, N.Y. TIMES, Feb. 17, 2006, http://www.nytimes.com/2006/02/17/nyregion/17ports.html (“Stewart Baker, assistant secretary for policy at the Department of Homeland Security, said his department had no information about Dubai Ports World that justified an objection to the deal. Indeed, he said, the company has cooperated with the department in its efforts to secure American ports and ships in foreign ports. ‘We did not find derogatory information in our review,’ he said.”).}

At the end of 2005, confidence in President George W. Bush and the Executive Branch was at a near record low as the wars in Iraq and Afghanistan grew more unpopular. Once members of Congress, ever-cognizant of mid-term Congressional elections, became aware that CFIUS had authorized the P&O acquisition, they did not miss the opportunity to...
demonstrate their patriotism by opposing the acquisition. In what I characterize as both politics as usual and Congressional racial profiling, Democrats and Republicans denounced CFIUS for approving the DPW transaction without a full investigation. These critics asserted that the United Arab Emirates, of which Dubai is a member, was a state supporter of terrorism.  

President Bush pointed out that port security was the responsibility of the U.S. Coast Guard, Homeland Security, and U.S. Customs and Border Protection, and that management of ports by P&O prior to or following a sale to DPW would have no impact on the security of our ports. The Administration explained that DPW had been the first Middle Eastern entity to join the multinational Container Security Initiative, a program designed to protect global trade from terrorism. The public was also informed that Dubai had been the first to join the Department of Energy’s Megaports Initiative, a nuclear nonproliferation program aimed at stopping illicit shipments of nuclear and radioactive material.

Even the Chairman of the Joint Chiefs of Staff became involved in this “perfect storm” of domestic politics. Peter Pace, a Marine Corps four-star general, dismissed the terror-link allegations. “In everything that we have asked and worked with [the UAE] on, they have proven to be very, very solid partners.”

Once P&O shareholders approved the sale in early March, to assuage fears generated by the politicians and the media, DPW voluntarily submitted to the further forty-five day CFIUS investigation demanded by Congressional critics, the very investigation CFIUS had determined was unnecessary. The November elections were just seven months away, and the House Appropriations Committee, apparently eager to demonstrate that

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81. “Mr. Schumer said that he was concerned that the company could be infiltrated by terrorists with designs on exploiting the vulnerability of American ports. He noted that the September 11 attacks were financed in part by money that passed through banks in the United Arab Emirates.” Id.


83. The Initiative implemented information-sharing and scanning technologies, as well as other administrative and technological methods, including pre-screening of containers prior to shipment.


they could not be outmaneuvered by the unpopular President Bush, CFIUS, the Chairman of the Joint Chiefs, and DPW, overwhelmingly approved a legislative amendment prohibiting the DPW transaction. This action was rendered veto-proof because it was attached to an appropriation of funds for the wars in Afghanistan and Iraq.\textsuperscript{88} Claiming to enhance national security, patriotic Members of Congress courageously jumped in where the War on Terror President, multiple agencies of the Executive Branch, and the Chairman of the Joint Chiefs of Staff saw no need to go. Thus, Congress heroically acted to prohibit a change in management of U.S. ports from “Brits” to “Arabs.” “The two parties seemed to be more interested in gaining recognition that their party was stronger on national security issues than they were in learning the actual effects that the transaction would produce. It was an election year after all.”\textsuperscript{89}

F. Sovereign Wealth Fund Investments in the 2007 Economic Slowdown

The CNOOC and DPW affairs raised public awareness of SWF investments. While we do know of the recent increase in investments by SWFs in public companies, we know very little about any other investments by SWFs. If we accept the estimate of $3.8 trillion as the size of SWF investable assets in mid-2009 and the projection of $1 trillion as the annual rate of increase of SWF assets in future years,\textsuperscript{90} there can be no doubt that the SWFs lack of transparency hides a great deal. As the economic crisis began to develop at the close of 2006 and early in 2007, the problem of how SWFs could earn acceptable returns on their ever-increasing amounts of investable funds remained.

The subprime mortgage crisis became apparent in the United States in early 2007. U.S. housing prices had stopped rising at their unprecedented pace of the previous few years, and the market for securitized mortgages and other derivative instruments created from mortgages and mortgage derivatives that had been marketed as risk-free, collapsed. The world’s largest commercial and investment banks, having fully imbibed the intoxicating, virtually risk free securitized mortgage instruments Wall Street alchemists had concocted, found that at that moment these securities had little market value. This collapse in value created a desperate need for bank capital. The somnolent regulatory agencies of the leading developed nations made the same discovery at this time. As had happened in earlier banking crises, bank regulators could not or would not close these

\textsuperscript{88} House Panel Votes to Block Ports Deal, FOX NEWS, Mar. 9, 2006, http://www.foxnews.com/story/0,2933,187147,00.html.

\textsuperscript{89} Waseam Azmeh, Sovereign Wealth Funds (Nov. 17, 2008) (unpublished manuscript on file with the author at MSU College of Law).

\textsuperscript{90} Surowiecki, supra note 58.
institutions. They had become undercapitalized by tens of billions but were considered “too big to fail.”

SWFs were well positioned to be the source of the required additional bank capital. Faced with the need for increasing the return on their portfolios, SWF managers understood the opportunity presented by the banks’ predicament: banks were under regulatory pressure to offer favorable terms to secure such investments, and the SWFs had the cash. Investing in the world’s leading banks would give participating SWFs new credibility and stature in the global financial community. What could be more attractive than an investment in the premier financial institutions in the world’s largest, most successful economies? Equity investments in Citigroup, Deutsche Bank, Merrill Lynch, Morgan Stanley, Standard Chartered Bank, and UBS provided quite favorable returns, especially in light of the rate of return available on U.S. Treasuries and related instruments. The fact that the U.S. Government and other leading nations had, explicitly or implicitly, deemed these institutions “too big to fail”\textsuperscript{91} was an important added bonus. The cash-gorged SWFs did not miss this opportunity to take supposedly ultra-safe positions in financial institutions, which had been household names for generations. The investments in western money center financial institutions set out in Table 2 are indicative of the opportunities seized by the SWFs.

<table>
<thead>
<tr>
<th>Financial Institution</th>
<th>Billions Invested by all SWFs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deutsche Bank</td>
<td>$1.8</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>$4</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>$5</td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>$6.4</td>
</tr>
<tr>
<td>Citigroup</td>
<td>$17.5</td>
</tr>
<tr>
<td>UBS</td>
<td>$24.2</td>
</tr>
</tbody>
</table>

\textsuperscript{91} Patrice Hill, \textit{Citigroup, Other Banks in Trouble}, \textit{Wash. Times}, Nov. 21, 2007, http://www.washingtontimes.com/news/2008/nov/21/citigroup-other-banks-in-new-trouble/print/ (“While the banks’ woes are real and growing, Mr. Beales[, an investment analyst,] said the drubbing of bank shares this week has been overdone. ‘It’s highly unlikely that the end game for Citi or its big rivals is collapse,’ he said. ‘They remain too big to fail.’”).

\textsuperscript{92} \textit{See} Kern, \textit{supra} note 45; \textit{Monitor Group}, \textit{supra} note 22.
G. Financial Crisis: Sovereign Wealth Funds Stabilize Financial Institutions

Through the first months of 2008, the financial community, the business press, and government officials dealt with the instability in the global banking system as merely the most recent, although perhaps more severe, version of prior episodes of banking instability brought on by real estate related problems. Parallels were drawn to the savings and loan problems in the United States in the late 1980s. The trigger for bank losses this time was subprime mortgages, which had been packaged and repackaged as securitized investments, and which the banks had purchased in the search for higher yields and larger personal paydays.

H. Mortgage Problems Become a Crisis

Concern about the stability of banks and the international financial system developed during 2007 and grew more serious in early 2008. In mid-March 2008, however, the global economy began to change for the worst. Bear Stearns, Wall Street’s fifth largest investment bank, which, like many other financial institutions, had been funding its capital needs in the very liquid overnight-borrowing market, suddenly became a pariah to lenders. On Monday, March 10, a rumor spread that Bear Stearns was in trouble, and by Thursday, March 13, more than $15 billion in hedge fund prime brokerage accounts had been withdrawn from the firm. This quickly led to disaster. Bear Stearns suddenly found it nearly impossible to rollover its overnight borrowings. An emergency rescue of Bear Stearns was arranged by federal authorities over the March 15–16 weekend. JPMorgan Chase, the one major bank not threatened by high exposure to the subprime mortgage problems plaguing the industry, with $30 billion in support from the Federal Reserve Bank, acquired Bear Stearns for $2 per share.

The economic crisis continued to deteriorate over the next six months. On September 8, 2008, the world learned of the demise of Fannie Mae and Freddie Mac. Seven days later, Lehman Brothers filed for bankruptcy.

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94. Within days the acquisition price was increased to $10 per share. For the fascinating story of the reasons for this increase see Steven M. Davidoff, Gods of War 145–46 (2009).


96. Lehman Brothers faced huge losses arising out of the subprime mortgage crisis. In the first half of 2008, Lehman stock lost almost 75% of its value. However, on August 22, shares in Lehman closed up sharply on reports that the Korea Development Bank was considering buying the failing bank. However, when the Korea Development Bank did not
protection, and the true condition of American International Group, Inc., which by 2009 had received more than $160 billion in federal rescue support, became public.

III. FOREIGN INVESTMENT IN AMERICA: ESSENTIAL FOR THREE CENTURIES

Foreign investment is a vital component of American prosperity. This began in 1607 when shareholders of the Virginia Company sent settlers to Jamestown in the New World in search of wealth. Foreign nations funded the American Revolution out of political and commercial rivalry with Great Britain. The Bank of the United States was 62% owned by foreigners in 1803.\textsuperscript{97} European debt and equity investments greatly accelerated the development of our railroads and created many mining, meatpacking, and other industries in the nineteenth century.

The long history of foreign investment in the United States includes many federal laws restricting foreign investment. Early examples are the 1841 Preemption Act\textsuperscript{98} and the 1872 Mining Act,\textsuperscript{99} which reflect attempts to regulate the settlement of the vast open lands west of the Appalachians. They were not a response to national security threats to a nation protected by thousands of miles of ocean. Such restrictions did little to reduce foreign investment.\textsuperscript{100}

Limitations on foreign investment accelerated in the twentieth century. Congress enacted the Pickett Act in 1909 to limit foreign claims on western oil-producing land.\textsuperscript{101} In 1912, Congress authorized the president to restrict foreign investment in the fledgling radio industry.\textsuperscript{102} In the midst of World

consummate the acquisition, Lehman shares collapsed again. The situation with Lehman grew worse on September 9, 2008, when the Dow Jones industrial average lost 300 points partly due to fears over the fate of Lehman. In addition, even though the U.S. government had previously arranged the rescue of Bear Stearns and had just bailed out Freddie Mac and Fannie Mae by announcing hundreds of billions of dollars in support from the U.S. Treasury, the government determined not to assist Lehman. \textit{See} Davidoff & Zaring, \textit{supra} note 93.

\textsuperscript{97} \textsc{Samuel Blodget}, \textit{Economica: A Statistical Manual for the United States of America} 198 (1806).


\textsuperscript{99} The 1872 Federal Mining Act intended to add incentive to exploration of western lands by creating a claim-patent process for land acquisition. The Act added “proof of citizenship” as a part of the process, although that seems to have been meant to incentivize Americans to set up companies for foreign investment. General Mining Act of 1872 30 U.S.C. §§ 22–47 (2006).

\textsuperscript{100} GAO, \textit{supra} note 23, at 18.

\textsuperscript{101} Pickett Act of 1910, ch. 421, 36 Stat. 847 (repealed in 1943).

\textsuperscript{102} President Woodrow Wilson seized control over all U.S. foreign-owned radio stations in 1917 under the Radio Act of 1912. Later, the General Electric Company spun-off the Radio Corporation of America which had been formed as a domestic monopoly at the urging of the U.S. Navy. \textsc{Edward M. Graham & David M. Marchick}, \textit{U.S. National Security and Foreign Direct Investment} 10 (2006).
War I, President Woodrow Wilson seized control of foreign-owned radio stations.\textsuperscript{103}

In 1920, Congress enacted the Mineral Lands Leasing Act, which limited a foreign oil company’s ability to drill in the United States by requiring them to lease the land from the Government.\textsuperscript{104} After World War II, with Europe’s capital base destroyed, the United States became the major source of global investment capital. As Europe and Japan gradually became more prosperous, the thriving American consumer economy attracted increasing amounts of foreign investment.

A. The Impact of Recent International Developments

The oil embargo imposed by the Organization of Petroleum Exporting Countries (“OPEC”) in 1973 introduced a totally new category of investor. The embargo resulted in a significant increase in the price of crude oil, which resulted in a major transfer of wealth to OPEC members, particularly in the Middle East. These “petro-dollars” were recycled by their new owners back to the oil importing industrialized nations, especially the United States, where most funds were invested in traditional “risk-free” U.S. Treasury and related instruments. Though the 1973 oil embargo stimulated public discussion about the threat to America from the accumulation of dollars in the OPEC countries, the petro-dollars invested in the United States were not viewed as a threat. There was no indication that Middle Eastern investors intended to buy control of American companies. Public attention focused on the unfamiliar concept of foreigners having enormous amounts of investable dollars. It was assumed that these foreigners had the same investment goals as other investors: an increase in wealth.

A further wave of foreign investment occurred in the early 1980s. A portion of this investable cash derived from a second abrupt increase in the cost of crude oil triggered by the 1979 Islamic revolution in Iran. A new and different foreign investment threat from Asia emerged shortly thereafter.

By 1980 Japan had fully recovered from the devastation of World War II, and in the late 1980s Japan modified its Foreign Exchange Control Law to permit Japanese citizens and companies to invest abroad more easily.\textsuperscript{105} Over the next decade the Japanese yen strengthened against the U.S. dollar, making investments in the U.S. economy very attractive for Japanese investors. By 1989, Japanese direct and portfolio investments accounted for

\textsuperscript{103} See Radio Act of 1912, ch. 287, § 2, 37 Stat. 302 (repealed 1927).


17% of all foreign investment in the United States.\textsuperscript{106} Japanese investments were sometimes large; some were quite conspicuous.\textsuperscript{107} The appearance of these large pools of foreign capital in the Middle East and Japan generated concern in the United States over foreign investment that remains strong today.

B. The Modern Approach to Investment by Foreign Investors

The United States has enjoyed the benefits of foreign investment\textsuperscript{108} and has consistently espoused openness toward investments by foreigners.\textsuperscript{109} The restrictions U.S. policy imposed on foreign investment were directed, until recently, at specific categories of activities and assets.\textsuperscript{110} Such restrictions were rooted in protecting investment opportunities for Americans, not the perception that our national security could be threatened by foreign investors.

More recently, policy concerns have focused upon a concern for national security. Earlier restrictions targeted foreigners as a broad category and did not focus on the unique characteristics of particular types of foreign investors. U.S. legislators previously assumed, without analysis, that foreign investors were rational economic actors, seeking maximum returns from their investments in the United States. The U.S. economic regulatory framework has been based upon the nature of the investment to be made, not upon the character of the foreign investor.\textsuperscript{111} We have assumed that investors seek wealth maximization. An unstated assumption has been that all market participants, including foreigners, invest solely to increase their own wealth. The increased investment activity of SWFs and SOEs\textsuperscript{112} has led to a reconsideration of this assumption.

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\textsuperscript{107} Pebble Beach Golf Course and Rockefeller Center in New York City are prominent examples of high profile investments, perhaps chosen specifically because they were high profile.

\textsuperscript{108} GAO, \textit{FOREIGN INVESTMENT: LAWS AND POLICIES REGULATING FOREIGN INVESTMENT IN 10 COUNTRIES}, GAO-08-320, (2008) (stating that other nations too have these restrictions). Indeed, the United States is ranked relatively high on the list of nations and their openness to foreign investment. \textit{Id.}


\textsuperscript{110} GAO, \textit{supra} note 23.


\textsuperscript{112} See \textit{supra} Part II.A.
\end{flushright}
C. The Committee on Foreign Investment in the United States

CFIUS is the backbone of America’s legislative efforts to protect the nation from any risk arising from foreign investments. The current CFIUS process has evolved over more than three decades of practice and intermittent review of its authority and procedures.\(^{113}\)

1975 — The Establishment of CFIUS

At the height of the first OPEC oil embargo in 1974, Congress mandated a study to investigate direct and portfolio investments in the United States by foreign persons and entities.\(^{114}\) The following year President Gerald Ford signed an Executive Order\(^{115}\) establishing an Executive Branch committee to review certain investments in the United States by foreign investors. The focus was the risk presented by control of U.S companies by foreigners; there was no explicit concern about direct or indirect control of American businesses by foreign governments. The government entity responsible for reviewing investments by foreigners was and remains CFIUS. This Committee operates almost totally outside the public arena, but we do have some perspective on the level of CFIUS activity.\(^{116}\) In 2006, there were approximately 10,000 merger transactions in the United States. Of these, 1730 involved a foreign party, but only 113 required review by CFIUS. According to Deputy Secretary of the Treasury, Robert Kimmitt, not one of these CFIUS-reviewed transactions was blocked.\(^{117}\)

1988 — The Exon-Florio Amendment

CFIUS operated pursuant to President Ford’s Executive Order for more than a decade. During the 1980’s, protection of American technology companies became a national security concern. In 1988, Congress amended the Defense Production Act of 1950 by enacting the Exon-Florio Amendment,\(^ {118}\) which empowered the President to investigate “mergers, acquisitions, and takeovers” that would result in a foreign person achieving control over a company or business\(^ {119}\) where such control would impair national security. Implementation and enforcement of Exon – Florio was delegated to CFIUS.\(^ {120}\)

\(^{113}\) While CFIUS has been a distinctly American response and is the focus of this Article, German Chancellor Angela Merkel has called for a CFIUS-like structure for the EU. Germany and France already have similar legislation in place.


1993 — The Byrd Amendment

Congressional concern that the Committee was not being aggressive about protecting American security led Senator Robert Byrd to propose new amendments to CFIUS authority. The Byrd Amendment, enacted as section 837(a) of the National Defense Authorization Act for Fiscal Year 1993, changed Section 721 of the Defense Production Act. The change required an investigation in cases where the acquirer is controlled by or acting on behalf of a foreign government and the acquisition “could result in control of a person engaged in interstate commerce in the U.S. that could affect the national security of the [United States].”

2007 — FINSA

In addition to the CNOOC and DPW transactions, there have been four recent additional proposed acquisitions that involved issues of national security but did not attract intense media attention. These additional transactions were:

- The sale of Tyco International’s undersea fiber-optic cable network to an Indian firm;
- The Chinese computer company Lenovo’s purchase of IBM’s personal computer business;
- The proposed acquisition of a small internet security business, Sourcefire, Inc., by Check Point, an Israeli company, which did not proceed after an announcement that CFIUS opposed the transaction; and

Security company Check Point Software Technologies called off its planned $225 million acquisition of intrusion-prevention firm Sourcefire on Thursday, a week before a federal watchdog was scheduled to release a report which insiders say would have blocked the merger on the grounds of national-security interests. . . . The proposed Check Point acquisition was under initial review by the U.S. Treasury-led CFIUS, when the Associated Press broke the news that United Arab Emirates-based Dubai World Ports planned to close a deal which would have given the company responsibility for security at six major U.S. ports. The further investigation by CFIUS into Check Point’s proposed purchase of Sourcefire was announced the following day.

Congress was spurred to take action by these four transactions, the CNOOC and DPW affairs, and the hundreds of billions of dollars that continued to accumulate in SWFs, both in the Middle East, from the ever-increasing price of crude oil, and in Asia, from the balance of trade surpluses fed by debt-addicted American consumers’ insatiable appetite for more goods. Congressional options included legislation that reduced America’s consumption of imported oil, addiction to consumer debt, or both. Congress, however, preferred to focus on where the SWFs were investing, rather than on the unsustainable outflow of dollars. In 2007 Congress enacted the Foreign Investment and National Security Act\footnote{Richard Brand & Ilya Shapiro, \textit{A Step in the Right Direction}, \textit{Weekly Standard}, Dec. 19, 2007, http://www.weeklystandard.com/Content/Public/Articles/000%5C000%5C014%5C494abixg.asp.} (“FINSA”), which mandated new standards designed to bring CFIUS investment review procedures under more direct Congressional oversight. On behalf of the Committee, the Treasury Department issued final implementing regulations on November 14, 2008. On December 8, 2008, the Department of the Treasury’s Office of Investment Security published new regulations that enabled CFIUS to assess the impact of SWF investments on national security and to mitigate any potential threats. Ultimately, Congress enacted the Foreign Investment and National Security Act of 2007, Public L. No. 110-49, 121 Stat. 246 (2007) (codified as amended 50 U.S.C. App. 2170(f) (2007)).

\begin{itemize}
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\item In November 2007, Sequoia Voting Systems, the nation’s third-largest electronic voting machine maker, announced that the company had been sold to private U.S. investors. This would be an unremarkable transaction except that the seller, Smartmatic Corporation, is a Venezuelan-owned company close to the government of Hugo Chávez. And the sale was forced by a belated investigation by the Committee on Foreign Investment in the United States (CFIUS). But for the unprecedented unwinding of Smartmatic’s ownership — which almost did not happen — Chávez would be in a position to influence the outcome of next year’s presidential election. . . . CFIUS opened an investigation only after Rep. Carolyn Maloney (D-NY), who chairs the subcommittee overseeing CFIUS and who co-authored FINSA, wrote a letter to then-Treasury Secretary John Snow inquiring whether the Venezuelan government could use Sequoia to manipulate U.S. elections. Maloney cited the fact that the Venezuelan state had invested in Smartmatic’s affiliates, the company’s current ownership was buried in a labyrinth of offshore trusts, and revelations that Sequoia had flown fifteen Venezuelan nationals to Chicago to tabulate votes in a local election.
\end{itemize}
\end{itemize}
“Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States.”

CFIUS now operates as prescribed by FINSA.

1. **CFIUS Membership**

CFIUS membership, as established by the statute, consists of the heads of several Executive Branch departments and offices. These are the Department of Justice, Department of Homeland Security, Department of Commerce, Department of Defense, Department of State, and the Department of Energy. The Treasury Secretary serves as the chair of CFIUS. In addition, two agencies have membership as non-voting, ex-officio members. Those are the Director of National Intelligence and the Secretary of Labor. Other heads of agencies, departments, or offices may be added as the President deems appropriate.

2. **CFIUS Transactions**

CFIUS is charged with reviewing and reporting to Congress on any proposed “covered transaction”. A “covered transaction” is any transaction that “could result in foreign control of any person engaged in interstate commerce in the United States by a foreign government.”

CFIUS retains the flexibility to determine control on a case by case basis. Will control be found if the foreigner does not have a majority of the board of directors or the formal right to nominate candidates for board and executive positions? How should convertible securities be handled? What if the SWF is the principal creditor of a debt-strapped defense contractor? There is no end to the variations and perturbations careful lawyers may propose as parties attempt to arrange the best possible positions for their clients while not triggering the murky CFIUS standards. The lack of a bright line definition of control is no accident. Any competent lawyer can work around a clear, bright line test. As Paul Rose has observed: “The uncertainty of the rules’ application will likely encourage SWFs to maintain their shareholding strategy of passivity and understated influence.”

130.  Id. at app. § 2170(a)(3).
131. See Paul Rose, *Sovereign Wealth Funds: Active or Passive Investors?*, 118 Yale L. J. 104 (Pocket Part 2008). To date, SWF investments have been carefully arranged so as not to trigger reporting and review thresholds of other U.S. legislation. *Id.* As one example, SWF investments in financial institutions have been “passive” and have been kept below the 10% reporting threshold of the Bank Holding Company Act. *Id.*
FINSA has expanded CFIUS’ scope of authority by specifying that the term “national security” includes issues relating to “homeland security,”

132 defining “homeland security” to include America’s “critical infrastructure,”

133 and providing that the term “critical infrastructure” encompasses “critical technologies,” which term encompasses “technology, components[,] or items essential to national defense.”

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Another series of issues is presented by the CFIUS element of acting “on behalf of a foreign government.” Exactly when is a nominally private entity or party to be considered acting on behalf of a foreign sovereign? Russian oligarchs, fabulously wealthy individuals and families from the United Arab Emirates or Saudi Arabia, and Chinese SOEs are just a few examples of this fertile area of CFIUS ambiguity.

In contrast to this ambiguity, the regulations do make one thing clear, a 10% or smaller holding of voting shares exempta transaction from CFIUS review.

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3. CFIUS Procedures

The formal CFIUS process has four steps. The initial phase is notice to the Committee by the companies involved disclosing that a transaction is being considered. The notice must include a description of the business that the domestic company does with U.S. Government agencies, if such business has possible national security ramifications.

136 Second, a thirty-day “National Security Review”

137 is then conducted under the direction of a lead Executive Branch department designated by CFIUS. This review determines whether there are national security concerns.

138 If national security concerns are identified or if the transaction is foreign government controlled and the parties wish to continue with the transaction, the Committee conducts a forty-five day investigation into the national security concerns as the third step of the process.

139 As a practical matter, CFIUS may negotiate mitigation agreements and arrangements to satisfy the Committee that U.S. security interests will continue to be protected. Such agreements may include ongoing covenants and obligations that can be later enforced by CFIUS. Finally, CFIUS issues a recommendation proposing “a Presidential decision to permit, suspend, or prohibit the acquisition.”

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132. 50 U.S.C. app. § 2170(a)(5).
133. Id. app. § 2170(a)(5)–(6).
134. Id. app. § 2170(a)(7).
135. 31 C.F.R. § 800.302(b) (2009).
137. Id. app. § 2170(b)(1)(E).
138. Id. app. § 2170(b)(1)(B).
139. Id. app. § 2170(b)(2)(B)–(C).
140. Id. app. § 2170(d)(1).
In reviewing a covered transaction that has national security implications, CFIUS considers a broad range of issues, including an extensive list of “national security factors” taken from the Defense Production Act. These “national security factors” include:

- Domestic production needed for projected national defense requirements;
- The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
- Control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;
- The possible effects of the transaction on sales of military goods, equipment, or technology to a country that the Secretary of State has identified as supporting terrorism or as being of concern regarding proliferation of missiles or chemical and biological weapons; to a country that the Secretary of Defense has identified as posing a potential regional military threat to the interests of the United States; or to a country listed on the Nuclear Non-Proliferation-Special Country List or any successor list;
- The potential effects of the transaction on U.S. international technological leadership in areas affecting U.S. national security.

141. Id. app. § 2170(f).
143. Critical sectors of technological leadership include:

1. Advanced Materials and Processing
   1.1 Processes for Super Alloys, Polymers, etc.
   1.2 Semiconductor Materials
   1.3 Ceramics
   1.4 Fiber-reinforced Composites and Metal Matrix Composites
   1.5 Super Alloys
   1.6 Polymeric Materials, Plastic Fabricators, Homogenous Injections, Extrusions
   1.7 Energetic Materials (explosives, propellants, etc.)
   1.8 Metamaterials (nanostructures with special properties)
2. Chemicals
3. Advanced Manufacturing
4. Information Technology
5. Telecommunications
6. Microelectronics
7. Semiconductor Fabrication Equipment
8. Electronics: Military Related
9. Biotechnology
10. Professional and Scientific Instruments
11. Aerospace and Surface Transportation
12. Energy
13. Space Systems
14. Marine Systems
The potential national security-related effects on U.S. critical infrastructure,\textsuperscript{144} including major energy assets;
• The potential national security-related effects on U.S. critical technologies;\textsuperscript{145}
• Whether the covered transaction is a foreign government controlled transaction\textsuperscript{146} that could result in the control of a U.S. business by a foreign government or an entity controlled or acting on behalf of a foreign government;
• A review of the current assessment of the adherence of the subject country to nonproliferation control regimes; the relationship of such country with the United States, specifically in its record on cooperating in count-terrorism efforts; and the potential for transshipment of diversion of technologies with military applications, including an analysis of national export control laws and regulations;
• The long-term projection of U.S. requirements for sources of energy and other critical resources and materials; and
• Such other factors as the President or the Committee may determine to be appropriate, generally, or in connection with a specific review or investigation.\textsuperscript{147}

IV. THE SANTIAGO PRINCIPLES

FINSA was the Congressional reaction to the perceived threat from the increase in size and impact of SWF investments in the United States. Other nations were also concerned. The OECD, representing most developed nations, also considered the challenge posed by this new, uncomprehended threat. OECD concerns were similar to those expressed in the United States. The large pools of SWF investable cash under the control and management of other nations present the risk that SWFs might not always act like private investors.\textsuperscript{148} This concern is not irrational, but presents a serious issue for responsible leaders of all nations. There is the possibility that critical domestic economic resources might come under the control of SWFs or SOEs that could have political purposes or goals different from those of traditional private investors. OECD concerns have focused on the

\textsuperscript{144} 50 U.S.C. app. § 2170(a)(6) (defining “critical infrastructure” as “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.”).

\textsuperscript{145} Id. app. § 2071(a)(7) (providing that “critical technologies” include “critical technology, critical components, or critical technology items essential to national defense.”).

\textsuperscript{146} Id. app. § 2170(f)(8).

\textsuperscript{147} Id. app. § 2170(f)(11).

\textsuperscript{148} See generally Edwin M. Truman, Sovereign Wealth Funds: The Need for Greater Transparency and Accountability, Petersen Inst. For Int’l Econ. 1 (Aug. 2007) (highlighting the fact that SWFs have the potential to complicate the thin line between public and private investment policy).
opacity of SWFs with respect to their investment goals, current plans, and ownership details.

Early in 2008, the OECD prompted the IMF to take action. The IMF cooperated with a group of twenty-six leading SWFs in organizing the IWG of SWFs. The IWG mission was to prepare guidance that would allay the concerns of investee nations with respect to SWF investment activities.\footnote{INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS: GENERALLY ACCEPTED PRINCIPLES AND PRACTICES “SANTIAGO PRINCIPLES” 28–31 (Oct. 2008), http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf (providing a list of IWG Countries, SWFs, and institutions that participated in the IWG meetings). See infra App. B.} By October 2008, the IWG produced its 24 Generally Accepted Principles and Practices.\footnote{There are in fact 24 Santiago Principles. See generally Santiago Principles, \textit{supra} note 149. Only the hypothetical introducing this Article has a GAPP 25.} The GAPP was intended “to identify [a] framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements.”\footnote{See for example GAPPs 5, 11, 12, 17, 20. \textit{Id. See infra} App. B.}

The GAPP, also known as the “Santiago Principles,” are informative and reassuring to read, but as a document drafted by representatives of sovereign nations, they have absolutely no binding force and carry no meaningful weight. As the IWG itself makes perfectly clear in its formal \textit{Introduction to the GAPP}: “The GAPP is a voluntary set of principles and practices that the members of the IWG support and have either implemented or aspire to implement.”\footnote{Santiago Principles, \textit{supra} note 149, at 5 (emphasis added).}

The GAPP and this work of the IWG in coordination with the OECD and IMF need not be ignored. Neither should it be relied upon. The Santiago Principles have not had, and will not have, any meaningful, substantive impact on SWFs or their investments. Each of the 24 principles set forth in the GAPP uses the verb “should.” These principles do not relieve the concerns of those who perceive a threat from SWFs.\footnote{Indeed some commentators have derided the entire effort, perhaps losing focus on the inescapable reality of what “sovereign” means. What is disappointing is [the] utter ineffectiveness of the GAPP regime. The Principles accomplish nothing but a reiteration of the least common denominators of the status quo. It seems that the representatives of the Western free markets, in various states of dependency and desperation, suspended their reservations about the creeping resurgence of authoritarian capitalism to satisfy their national thirsts for liquidity. Buhi, \textit{supra} note 66, at 198.} While the dialog may have made SWF managers more aware of the concerns of investee states, the GAPP does not eliminate the risk that a SWF might use its investment power to act against the interests of another nation. So long as
the word “sovereign” retains its current meaning; the risk presented by SWFs cannot be eliminated by proclaimed principles, or even promises made by entities that are ultimately instrumentalities of sovereign polities.

V. THE ECONOMIC CRISIS AND SOVEREIGN WEALTH FUNDS

One of the principal complaints the OECD investee nations have about SWFs is their near total lack of transparency. Some opacity is typical of institutional investors. For example, hedge funds are extremely protective of their financial privacy; they claim secrecy is vital to their trading strategies. Investment companies that manage mutual funds and public employee retirement funds do disclose details of their portfolio holdings and investment performance, and they are required to undergo regular, independent audits.

SWFs, on the other hand, as creatures of sovereign governments are free to do almost anything they like. As Victor Fleischer has detailed, because they are owned by a sovereign government, SWFs are not even taxed by the Internal Revenue Service on their U.S. investment earnings or gains. Speaking of his SWF’s transparency, the Chairman and Chief Executive Officer of China’s CIC said of the IWG’s GAPP: “We will increase transparency without harming the commercial interests of CIC. That is to say, it will be a gradual process . . . . If we are transparent on everything, the wolves will eat us up.”

For all but a very few SWFs there is no official, independently audited information on their investments. Verifiable details on total assets, investment philosophy and goals, portfolio allocation, or investment performance are simply not available. Accordingly, an exhaustive

154. United States v. Lara, 541 U.S. 193, 218 (2004) (defining sovereign as an “entity ‘in which independent and supreme authority is vested’”); U.S. Dep’t of State, Foreign Sovereign Immunities Act, http://travel.state.gov/law/info/judicial/judicial_693.html# (explaining that under a restrictive theory of sovereign immunity, a state or state instrumentality is immune from the jurisdiction of the courts of another state, except with respect to claims arising out of activities of the kind that may be carried on by private persons). Black’s Law Dictionary defines sovereignty as, “The power to do everything in a state without accountability,. . . . to make war or peace, to form treaties of alliance or of commerce with foreign nations, and the like.” BLACK’S LAW DICTIONARY 1396 (7th ed.1999).


158. The SWFs of Norway and New Zealand do provide much more information than other SWFs. Nevertheless, SWFs argue, as do hedge funds, that business operating information must not be made available since this disadvantages the fund.
examination of the actual performance of SWFs and their behavior in the recent economic chaos is not possible. But it is useful to review how the SWFs reacted to the worst decline in the equity markets since the Great Depression. The analysis that follows reveals that despite unprecedented, multi-billion dollar losses, SWFs have not panicked and sold their worst performing holdings. Indeed, the evidence we have confirms that, to date, SWFs have behaved as long-term, wealth-maximizing private investors.

The long-term nature of SWF investments is confirmed by some remarkable statistics in the Deutsche Bank Report. Over the fifteen years included in the Deutsche Bank SWF database, the gross value of all divestitures has been a modest $46 billion. With current SWF assets between $3 trillion and $4 trillion, this is a telling data point. Many privately managed U.S. funds have 100% or higher turnover annually. In this light the Deutsche Bank figure, amounting to less than 1.5% of current SWF assets over a fifteen-year period is astounding. This data persuasively establishes that SWFs have acted like long-term private investors, not hostile nations seeking to damage the economies of its enemies or pursuing commercial advantage for its own businesses.

An analysis of transactions completed by one group of SWFs was published by the combined resources of the Monitor Company Group LP and the Fondazione Eni Enrico Mattei, an Italian economic research institute. Monitor-FEEM identifies seventeen SWFs that meet its narrow definition of SWF. They tracked 1,158 of the transactions these funds have completed since 1995. In April, 2009, Monitor-FEEM published its first annual report (the “2008 SWF Annual Report”) summarizing the activities of this subset of SWFs during 2008. Selected data from the 2008 SWF Annual Report reveal that from January, 2007 to July, 2008, eight of the leading SWFs invested $63.1 billion in six of the world’s largest

161. We do need to keep in mind that there is little available data on the actual performance of sovereign wealth funds, including data on total portfolio allocation among various asset classes or investment portfolio turnover. We do not know, for example, what portion of the $3.8 trillion or so of SWF assets is invested in equities, and we have no data on turnover in the non-public portions of these portfolios.
162. Bader Al Sa’ad, managing director of the Kuwait Investment Authority, noted his SWFs’ long-term focus at Davos in January 2008: “Kuwait has been a Daimler shareholder since 1968 . . . [and a] BP shareholder since 1986. We are one of the most stable shareholders of these companies,” Joanne Baynham, Sovereign Wealth Funds: Friend or Foe, 1 Milton Asset Mgmt 1, 1–2 (2008).
163. Id.
164. Id.
financial institutions\textsuperscript{166} in twelve separate transactions.\textsuperscript{167} By March, 2009, this aggregate $63.1 billion investment had been reduced by the collapse of global equity markets to $17.6 billion.\textsuperscript{168} Few categories of legitimate investments have lost 70\% in value in so short a time.

Deutsche Bank Research provides a different source of SWF performance data with comparable findings. It has been tracking SWFs and providing performance updates for several years.\textsuperscript{169} Table 2 is based upon this Deutsche Bank data. Of the SWF investments in financial institutions included in Table 2, the two worst performers for the extremely short period of the current economic crisis are Merrill Lynch, where investors could have incurred a maximum potential loss of 85\%, and Citigroup, where the maximum possible loss was 96\%.

Other staggering losses suffered by SWFs include CIC’s ten percent stake in The Blackstone Group L.P., purchased with a much publicized $3 billion investment in April 2007. This investment was valued at less than $1 billion in mid-2009.\textsuperscript{170} A Dubai SWF invested $5.5 billion in MGM Mirage, a casino and hotel operator, with stock purchases made at prices ranging from $82 to $95.\textsuperscript{171} The stock then fell to $12.\textsuperscript{172} Temasek, the transparent Singapore SWF, publicly reported a loss of $27.7 billion for its fiscal year ending in March 2009.\textsuperscript{173} In September 2009, a second Singapore SWF, The Government of Singapore Investment Corporation (“GIC”),\textsuperscript{174} announced that its portfolio of more than $100 billion in international investments had lost more than 20\% of its value through March 2009.\textsuperscript{175} Deutsche Bank estimates that overall equity investment portfolios of SWFs (i.e., not just investments in financial institutions

\textsuperscript{166} UBS, Citigroup, Morgan Stanley, Merrill Lynch, Credit Suisse, and Deutsche Bank.

\textsuperscript{167} Fotak, Li, & Megginson, supra note 164. Indeed all but one of these investments were made in the 12 months preceding the shocking collapse of the New York based investment bank, Bear Stearns, in mid-March 2008. The collapse of Bear marked the awakening of the world to the enormity of the economic crisis of the first decade of the 21\textsuperscript{st} Century. The bankruptcy of Lehman Brothers Holdings, Inc. on September 15, 2008 confirmed this for any remaining skeptics.

\textsuperscript{168} Id. at 57.

\textsuperscript{169} See, e.g., Kern, supra note 45.

\textsuperscript{170} Sovereign Wealth: Winners and Losers, INVESTING STRATEGY, July 28, 2009.


\textsuperscript{172} Id.


\textsuperscript{175} Kevin Lim, UPDATE 1—Wealth Fund GIC’s Portfolio Recovers, Looks To Asia, REUTERS, Sept. 28, 2009, http://www.reuters.com/article/idUSIN48551520090928.
included in Table 2) may have fallen as much as 45% between January 2007 and mid-2009.\footnote{176}

Despite these unprecedented losses, SWFs did not succumb to panic and sell off their losing investments. The absence of panic selling, or indeed, any significant sell-off at all, is consistent with the conclusion that SWFs are managed by sophisticated investment managers with a long-term perspective. Thus, even without knowing the investment philosophy or long-term strategy for many of the SWFs, the available data suggests that SWFs have acted like private funds managed for wealth maximization.

\section*{A. SWF Investment Adjustments Arising from the Crisis}

Redeploying assets is the right of any investor, whether responsible to one or more private investors or to a sovereign nation. In an economic slowdown or crisis, however, funds that are set aside for future generations and thus deliberately removed from the immediate spending plans of the legislature or executive, are attractive to politicians dealing with projected budget deficits. Resisting the temptation to tap SWFs by redirecting investment to projects in the SWFs home jurisdiction or to current expenses can be particularly difficult, even if economically optimal.\footnote{177}

In the present crisis there has been domestic criticism in some jurisdictions that have SWFs.\footnote{178} Evidence exists of some refocusing of investment behavior by some SWFs triggered, at least in part, by domestic political pressures. A few examples that demonstrate the shift in investment behavior are listed below:

- Russia announced that it has removed $43.7 billion from one of its two SWFs to cover a shortfall in its 2009 budget.\footnote{179}
- Brazilian officials have discussed taking a portion of its SWF, established only at the end of 2008, to cover a possible upcoming election year budget shortfall in 2010.\footnote{180}
- The Kuwait Investment Authority formally announced that its massive SWF will refrain from further international investments and focus on domestic investing.\footnote{181}

\footnote{176. See Kern, supra note 45.}
\footnote{177. It might be noted in passing that the U.S. has seldom been able to resist the political pressures to spend and incur additional debt.}
\footnote{178. Just two examples are Norway and China.}
\footnote{180. Andre Soliani, Brazil May Tap Wealth Fund Next Year, Bernardo Says (Update2), \textit{BLOOMBERG}, Aug. 11, 2009, http://www.bloomberg.com/apps/news?pid=20670001&sid=aHzF5H4b4dA (“Brazil may tap its 15.8 billion real ($8.6 billion) sovereign wealth fund next year to help finance spending without widening the budget deficit,’ Planning and Budget Minister Paulo Bernardo said.”).}
Other SWFs have made international investments that involve immediate domestic benefits as well. For example, an Abu Dhabi investment with General Electric includes arrangements for GE renewable energy technology to be transferred to Masdar Energy City, a project of Abu Dhabi’s Mubadala Development Company.\(^\text{182}\) Also, a $2.7 billion Daimler transaction, completed in March, 2009, gave Aabar Investments a 9.1% stake in Daimler and involves a joint venture for electric automobiles and a training center in Abu Dhabi for its engineers.\(^\text{183}\)

- Temasek, with a long and impressive track record of successful investing, is considering packaging and selling portions of its investment portfolio to the public.\(^\text{184}\)

- Temasek is also considering managing investment funds for others. With its stellar investment record such a move should be successful and would blur “the line[] between public and private [debt]. This may be the future of sovereign wealth funds.”\(^\text{185}\)

- Norway has also taken advantage the opportunities accompanying the worldwide collapse of equity markets. It has announced a rebalancing of its entire portfolio. It now plans to have 60% of its portfolio in equities, an increase from the previous, more conservative allocation of 40%.\(^\text{186}\)

As further evidence that SWFs act like rational private investors, SWFs have been described in the press as “vulture” investors, the latter a term normally associated with aggressive hedge funds and others who have the cash to seize upon an opportunity to acquire “distressed” assets.\(^\text{187}\)

One impact of the crisis has been increased focus at home on the foreign investment activities of various SWFs. The transparent, super-large Norwegian Government Pension Fund — Global,\(^\text{188}\) has encountered significant domestic political pressures. In the September 2009 Norwegian election, each political party campaigned in part on the proper allocation of

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185. *Id.*


187. Zhang Ruimin, the Chairman and CEO of Haier, the world’s largest manufacturer of refrigerators, refers to his company’s acquisition targets as “stunned fish,” which are “good companies waylaid, often by circumstances beyond their control.” *Creative Destruction Proves Winning Strategy for Fridge-Maker*, FIN. TIMES, Sept. 10, 2009.

resources in the national SWF. Norway’s SWF acknowledges that domestic political considerations have had a direct impact on its investment decisions. Despite the objections of the SWF’s CEO, Norway has more than twenty-five companies on a blacklist for various, non-financial reasons. As one example, the Norwegian SWF’s holdings of Wal-Mart were sold because of that company’s resistance to labor union organizing efforts and other violations of workers’ human rights. Elbit, an Israeli company, has been blacklisted by Norway because it produces surveillance systems used on the wall separating the West Bank from Israel.\(^\text{189}\)

**B. The Crisis and the Chinese Reaction**

In analyzing the unique risks posed by SWFs, China is a special case. The dramatic growth of China’s soft power and influence is the hallmark of the first decade of the 21st century.\(^\text{190}\) Since 2004, the media has offered sound bites to the public that have routinely referred to the challenge China’s currently uniquely successful form of state capitalism\(^\text{191}\) poses to free market forms of capitalism. China’s stunning success requires that we take a brief look at its role in the global economy.\(^\text{192}\)

China’s $297 billion SWF, CIC, created only at the end of 2007, has been hyper-active during the crisis. China also has hundreds of billions of additional foreign exchange assets in its State Agency for Foreign Exchange (“SAFE”), which some believe also acts as a SWF, making unacknowledged international investments. China has also deployed its $2 trillion in foreign exchange reserves as loans from the state to support activities of Chinese SOEs in pursuit of goals that coincide with the diplomatic and economic goals of China itself.

The pace of foreign investment by Chinese SOEs and CIC has accelerated during the crisis. Foreign direct investment by Chinese companies totaled less than $50 billion in the five years ending in 2007. For 2008 and 2009, according to the Chinese Commerce Ministry, Chinese companies are on track to invest over $100 billion.\(^\text{193}\) Fortuitous timing and

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\(^{190}\) See supra text accompanying note 7.


\(^{192}\) See Fastest-Growing Economies Join G-8 Summit, CBS News, July 9, 2009, http://www.cbsnews.com/stories/2009/07/09/world/main5146008.shtml (China is noted as one of the five fastest growing market economies; this is evident by their invitation as guests to the annual G-8 Summit of 2009 to discuss issues ranging from international trade to global economic growth).

trillions in investable cash has led China, through its SWF and its SOEs, to act just like a wealth-maximizing private investor.

C. The Ice Cream Problem

While China’s acknowledged SWF, CIC, is not the largest such fund, China itself holds more than $2 trillion in foreign currency holdings, more dollar reserves than any other nation. Given the fall of the dollar against the Euro and the yen and the inflationary potential of the trillions of dollars of new commitments the U.S. Government has made to ameliorate the impact of the economic crisis, China can be viewed as a prisoner of its vast dollar holdings. Were it to attempt to sell its U.S. Treasury and related debt instruments, it is widely understood that the value of its dollar denominated holdings would immediately collapse. China fully recognizes this problem. It refers to the $1.2 trillion in dollar instruments as “melting ice cream.” China’s solution to this challenge is to spend its dollar assets to purchase or gain access to hard assets, including manufacturing facilities and commodities.

CIC reported in 2008 that it had invested less than 15% of its available assets, including 9% in bonds and fixed income securities and only 3.2% in equities, leaving 87%, or $260 billion, in cash and cash equivalents available to take advantage of the global drop in commodities and other prices. Although China’s $1.2 trillion in dollar assets may be “melting,” CIC, and China’s SOEs are in an ideal position to spend China’s dollar assets to acquire manufacturing assets, commodities, or interests in enterprises which control commodities, and to do so at favorable prices, which reflect the collapse of the global economy.

Chinese companies have purchased Hummer, one of General Motors’ automobile brands, and have sought to purchase both Opel, the German-based GM car manufacturer, and Volvo, a Ford Motors brand. The Chinese

194. Truman, supra note 148, at 16–17 (“The State Administration of Foreign Exchange (SAFE) holds a portfolio of international assets that is about 20 times the size of CIC’s international portfolio.”).

195. Indeed, even rumors that the Chinese government might decide to reduce its dollar dependency have triggered adverse market reaction.


offered to participate in the proposed purchase of SAAB, yet another GM brand being divested. Chinese SOEs have been extremely active in 2009. PetroChina signed a $33 billion agreement with Exxon to purchase liquefied natural gas from a new Australian offshore field.\textsuperscript{198} Other Chinese entities have purchased, or attempted to invest in Rio Tinto, a British-Australian mining giant, and Addax Petroleum, a Swiss-based company, with interests in oil fields in Nigeria, Canada, and elsewhere. In resource-rich Australia, the Australian Foreign Investment Review Board reviewed 90 separate Chinese investment proposals in just eighteen months.\textsuperscript{199}

During September, 2009, CIC announced a number of transactions indicative of its current approach — spending dollars to acquire real assets before the ice cream melts. CIC agreed to purchase $1.9 billion in the debt of Indonesia’s largest coal company, PT Bumi Resources and invested $850 million to purchase a 15% stake in Noble Group Ltd., based in Hong Kong, which owns and trades commodities.\textsuperscript{200} During the same week CIC reported committing $1 billion to Los Angeles-based Oaktree Capital Management.\textsuperscript{201} The following week it became public knowledge that (i) CNOOC was seeking to purchase access to six billion barrels of oil in Nigeria,\textsuperscript{202} (ii) Sinochem, a Chinese chemicals trading company, had offered to purchase an Australian agricultural chemicals maker, and (iii) China had invested $939 million to add to its interests in gas and oil producers in Kazakhstan.\textsuperscript{203}

China’s SWF has not been involved in all these transactions, but if there is a threat from Chinese ownership of assets, there is no reason to distinguish the risks presented by CIC, a SWF, and the Chinese SOEs, such as CNOOC, Sinochem, or PetroChina. Each of these SOEs could be subject to demands from China to conduct politically motivated investing.\textsuperscript{204}


\textsuperscript{200} Id.


\textsuperscript{204} Monk, \textit{supra} note 46, at 26.
It should also be quite clear, however, that each of these investments is consistent with the investment approach of a private investor, seeking long term investments in currently depressed assets of various types.

VI. CONCLUSION

A. General Observations

SWFs have the staying power to be long term investors. They are not under pressure from investors to generate quarterly short term gains. Long-term growth is often a SWF’s stated goal. Knowing their true, as opposed to stated, investment philosophies or strategies does not mean that an investee nation or its politically sensitive elected officials will know what an investing SWF might do in the future. This applies as well to privately held hedge funds and other types of investors. Markets in the United States and elsewhere have been regulated based upon the premise that investors are economically rational, acting in their own best interests. For rational investors qua investors, this means that these investors seek wealth maximization. Some fear the theoretical possibility that when a SWF acts in its own best interest, that interest may not be wealth maximization, but the political, diplomatic, or economic interests of its sovereign owner.

B. SWF’s Unique Characteristic: Domestic Political Pressures

The available evidence establishes that SWFs have thus far invested to maximize their wealth, just like large investment funds that are not controlled by sovereign nations. If CIC and other SWFs act like any other institutional investor or hedge fund, why the fear-mongering in the press? Can the problem be lack of transparency? Hedge funds and other large investors operate with their investing activities somewhat hidden from public knowledge. Some SWFs as well may not disclose much of what they hold or what they do as investors. But with a constant influx of investable funds and freedom from the demands of impatient investors for instant gratification, SWFs can and do invest for the long term. So where is the threat? If SWFs invest for the long term, their interests are aligned with the interests of the entities in which they have invested. Was there a need for CFIUS or FINSA or comparable legislation elsewhere?

The most important distinguishing feature of a SWF is not that it unwaveringly seeks its own political ends. Indeed, Senator Charles Schumer, Chairman of the Congressional Joint Economic Committee, has

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205. A Canadian newspaper recently carried Professor Fen Osler Hampson’s commentary entitled “The New China Syndrome: The Threat to Canada.” Hampson states, “Though its money is welcome, we should have no illusions that China is a normal investor that plays by our rules.” Hampson, supra note 191.
acknowledged that “[i]t would be perfectly rational to expect a government-controlled fund to have non-economic motivations.”

Rather, the unique characteristic of a SWF or SOE investment is the possibility that the sovereign will use its SWF or SOE investments for other than wealth-maximizing purposes. A sovereign could use its SWF to take politically motivated actions. There is no evidence that this has occurred. There is a long history of SWF investing with no political or non-economic purposes. Nevertheless, regardless of whether one believes the Chinese Communist Party, which ultimately controls China’s $2 trillion in foreign exchange, is a long-term economic investor or is intent upon undermining the United States and displacing U.S. hegemony, the possibility exists that diplomatic and political interests or home country economics could drive a sovereign to make an investment decision that is in the best interest of the sovereign but not the investee company. SWFs and SOEs are “complex political and economic institutions” subject to forces other than wealth-maximizing goals.

We have evidence that domestic demands have been accommodated by management of a few SWFs during the current economic crisis. But the resulting changes in SWF behavior are consistent with carefully considered investing decisions by well informed asset managers. Notwithstanding the long history of legitimate SWF investing and the benign results of the revealing stress test of SWF behavior during the most severe economic crisis in seventy-five years, the risk that a sovereign might direct a SWF to make a decision not based upon the interests of the investee company, but upon an inconsistent interest of that sovereign, cannot be eliminated. Moreover, SWF transparency and democracy may have the perverse impact of contributing to the political pressures on SWFs to take action in aid of the local economy.

It is precisely the transparency that the OECD and major investee nations seek, and that the IWG’s Santiago Principles promote, that gives some domestic constituencies of SWFs the information necessary to pressure a national SWF to change its investment philosophy or to abandon long-term investment international investing goals for immediate domestic needs.

207. See Gideon Rachman, China Makes Gains in its Bid to be the Next Top Dog, Fin. TIMES, Sep. 15, 2009, at 9.
208. Fleischer, supra note 155, at 152.
209. See generally Kern, supra note 45.
Investments by SWFs in the United States are subject to CFIUS. CFIUS has a quite loose definition of control. Thus, CFIUS can work to deal with the theoretical threat some perceive by assiduously reviewing SWF, SOE and other foreign investments in U.S. companies. We shall see over the years, as SWFs grow in relative importance, just how well CFIUS works.

C. The Bottom Line

This review began with a hypothetical scenario based upon worst case theories about SWFs and their influence upon the U.S. economy. SWFs are pools of fantastic wealth, which will only grow in significance as the global economy adjusts to higher energy prices, further economic development in Asia and Latin America, and less irresponsible borrowing by American consumers.

We have considered recent SWF investments in the world’s leading financial institutions and the losses almost immediately suffered by them as the subprime crisis developed into a global economic slowdown. We have looked briefly at CFIUS and FINSA, the Congressional response to the SWF threat. We have seen that investment activities of SWFs have been influenced by the financial crisis. We know of the 24 Santiago Principles of the IWG’s GAPP that are intended to head off criticism of SWFs. We have noted the perverse impact of transparency on the capacity of SWFs to behave like private investors, driven by wealth maximization.

SWFs will grow in importance as key factors in the global economy. So long as CFIUS is assiduously applied, it will serve the American public interest by permitting the United States to remain open to foreign investment while arming the federal government with instruments adequate to deal with transactions that could pose a danger to national security.
## Appendix A: Sovereign Wealth Fund Institute Roster of SWFs

<table>
<thead>
<tr>
<th>Country</th>
<th>Fund Name</th>
<th>Assets</th>
<th>Inception</th>
<th>Origin</th>
<th>SWF to Foreign Exchange Reserve Ratio</th>
<th>Linaburg-Maduelli Transparency Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAE - Abu Dhabi</td>
<td>Abu Dhabi Investment Authority</td>
<td>$627</td>
<td>1976</td>
<td>Oil</td>
<td>29.5</td>
<td>3</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>SAMA Foreign Holdings</td>
<td>$431</td>
<td>n/a</td>
<td>Oil</td>
<td>12.7</td>
<td>2</td>
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<td>Norway</td>
<td>Government Pension Fund – Global</td>
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<td>Sector</td>
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<td>1984</td>
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<td>Oil</td>
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<td>Diamonds &amp; Minerals</td>
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<td>Non-Commodity</td>
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<td>Trinidad &amp; Tobago</td>
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<td>2006</td>
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<td>Total Oil &amp; Gas Related</td>
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<td>Total Other</td>
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<td></td>
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APPENDIX B: IWG GENERALLY ACCEPTED PRINCIPLES AND PRACTICES (GAPP) – SANTIAGO PRINCIPLES

In furtherance of the “Objective and Purpose,” the IWG members either have implemented or intend to implement the following principles and practices, on a voluntary basis, each of which is subject to home country laws, regulations, requirements and obligations. This paragraph is an integral part of the GAPP.

GAPP 1. Principle
The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).
GAPP 1.1. Subprinciple. The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.
GAPP 1.2. Subprinciple. The key features of the SWF’s legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.

GAPP 2. Principle
The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP 3. Principle
Where the SWF’s activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle
There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF’s general approach to funding, withdrawal, and spending operations.
GAPP 4.1. Subprinciple. The source of SWF funding should be publicly disclosed.
GAPP 4.2. Subprinciple. The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP 5. Principle
The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.
GAPP 6. Principle
The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

GAPP 7. Principle
The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF’s operations.

GAPP 8. Principle
The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

GAPP 9. Principle
The operational management of the SWF should implement the SWF’s strategies in an independent manner and in accordance with clearly defined responsibilities.

GAPP 10. Principle
The accountability framework for the SWF’s operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

GAPP 11. Principle
An annual report and accompanying financial statements on the SWF’s operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

GAPP 12. Principle
The SWF’s operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

GAPP 13. Principle
Professional and ethical standards should be clearly defined and made known to the members of the SWF’s governing body(ies), management, and staff.
GAPP 14. Principle
Dealing with third parties for the purpose of the SWF’s operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP 15. Principle
SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP 16. Principle
The governance framework and objectives, as well as the manner in which the SWF’s management is operationally independent from the owner, should be publicly disclosed.

GAPP 17. Principle
Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP 18. Principle
The SWF’s investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

GAPP 18.1. Subprinciple. The investment policy should guide the SWF’s financial risk exposures and the possible use of leverage.

GAPP 18.2. Subprinciple. The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

GAPP 18.3. Subprinciple. A description of the investment policy of the SWF should be publicly disclosed.

GAPP 19. Principle
The SWF’s investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

GAPP 19.1. Subprinciple. If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

GAPP 19.2. Subprinciple. The management of an SWF’s assets should be consistent with what is generally accepted as sound asset management principles.
GAPP 20. Principle
The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP 21. Principle
SWFs view shareholder ownership rights as a fundamental element of their equity investments’ value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

GAPP 22. Principle
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

GAPP 22.1. Subprinciple. The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

GAPP 22.2. Subprinciple. The general approach to the SWF’s risk management framework should be publicly disclosed.

GAPP 23. Principle
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

GAPP 24. Principle
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.