

Private Equity Deals

Sovereign Funds: Opportunities and concerns

Introduction

Sovereign funds are not a new notion, for instance, the Kuwait Investment Board was created in 1953 from oil revenue.¹ But they are attracting so much attention now because of their size, their rapid growth having quadrupled in size between 2003 and 2007², and because they are investing in the US financial market institutions. This paper will explain the Sovereign Wealth Funds, address the concerns they raise as well as their importance, and try to get a view of how to balance the need for these funds with the dangers they represent.

I – What are Sovereign Wealth Funds

A - Definition

Sovereign Wealth Funds are investment funds owned by a national or state government.³ They are constituted in countries having no or minimal international debt, with the surplus that is not allocated to the reserves.⁴ And they are “managed separately from official currency reserves.”⁵ They are composed of various kinds of financial instruments, such as stocks and bonds,

¹ Wikipedia, *Sovereign Wealth Fund*, http://en.wikipedia.org/wiki/Sovereign_wealth_fund.

² SCOTT ALVAREZ, *Sovereign Wealth funds*, testimony at the Board of Governors of the Federal Reserve System (March 5, 2008). <http://www.federalreserve.gov/newsevents/testimony/alvarez20080305a.htm>. (hereafter, ALVAREZ)

³ Id.

⁴ See Wikipedia, *supra* note 1.

⁵ See LEE HUDSON TESLIK, *Sovereign Wealth Funds*, Council For Foreign Relations (January 18, 2008), <http://cfr.org/publication/15251>. (Hereafter TESLIK).

or property.⁶ They are also “entities that manage state savings for the purpose of investment.”⁷ These entities can be central banks, state pension funds, official investment companies, sovereign oil funds and others⁸

Sovereign Wealth Funds are not the only way for a country to hold money. First, there are international reserves funds that are used by the treasury or finance ministries and central banks of the states. Then there are funds that are promised by the state to the citizens, these funds are held by the Public pension funds. And States can also hold funds through state-owned enterprises which are companies fully or partly managed by the states, each of which may have its own assets and investments. In contrast to these, SWF’s typically seek riskier investments and a higher rate of return; they are run purely to increase the wealth of the state, not to pay any specific debt.”⁹

The most important SWF are the Abu Dhabi Investment Authority (Abu Dhabi), the Government Pension Fund of Norway (Norway), Government of Singapore Investment Corporation (Singapore), various funds in Saudi Arabia, Kuwait Investment Authority (Kuwait), China Investment Corporation (China), Temasek Holding (Singapore), Stabilization Fund of the Russian Federation (Russia), CPP Investment Board (Canada), Australia Government Future Fund (Australia), Qatar Investment Authority (Qatar), Alaska Permanent Fund (United States, Alaska), Libya, Brunei Investment Agency (Brunei), Korea Investment Corporation (South Korea), Khazanah Nasional (Malaysia), Kazakhstan National Fund (Kazakhstan), National

⁶ Wikipedia, supra note 1.

⁷ See *Id.*

⁸ See *Id.*

⁹ See TESLIK, supra note 3.

Stabilisation Fund (Taiwan), Oil Stabilization Fund (Iran).¹⁰ As this listing shows, Sovereign Wealth Funds are found in various kind of countries, some of which are developed while others are developing countries; some of these countries are known to promote democracies while other are suspected of promoting terrorism.

B- Size of SWF

The exact size of these funds cannot be known because usually governments do not disclose financial information and investment strategies.¹¹ Nevertheless, the total assets of the sovereign funds were estimated in the beginning of the current year at approximately \$3 trillion, which is double the amount of the hedge funds managed worldwide; but they are still far behind the funds managed by insurance companies, pension funds and other institutional investors.¹² The largest sovereign wealth fund is the Abu Dhabi Investment Authority that controls around \$875 billion in assets.¹³

C- Types of SF

There are typically two types of sovereign funds; Commodity funds and Non-commodity funds; **Commodity** funds are composed exclusively from funds earned from the export revenues of commodities belonging to the government or taxed by it.¹⁴ **Non commodity** funds are

¹⁰ WIKIPEDIA, supra note 1.

¹¹ See DANIELLA MARKHEIM, *Sovereign Wealth Funds and U.S. National Security*, The Heritage Foundation (March 6, 2008) <http://www.heritage.org/Research/TradeandForeignAid/hl1063.cfm>. (Hereafter MARKHEIM)

¹² See TESLIK, supra note 3; see also ALVAREZ supra note 2.

¹³ Id. citing a 2007 estimate from Morgan Stanley; See also Wikipedia, supra note 1.

¹⁴ See MARKHEIM supra note and See also TESLIK, supra note 11.

composed from “foreign exchange assets accumulated as a consequence of running persistent current account surpluses.”¹⁵

Each of the types of funds is used for different purposes. The commodity funds are usually used as a stabilization device, to stabilize the foreign exchange rates, prevent inflation due to the excess of foreign currency entering the country at a given time, and also for the equitable distribution of the money in the country.¹⁶ On the other hand, non-commodity funds are used “to make stand alone investments.”¹⁷

D - Reasons for growth

Many of those funds are owned by Oil exporting countries and the price of the barrel of crude Oil is in dollars. For the past few years the price of the barrel was increasing while the value of the dollar was decreasing; the price of the barrel has risen from just above 10\$ in the 90’s to over 100\$ in the beginning of 2008. The need of importing countries for Oil, no matter what the price is, led to a raise in the reserves of these exporting countries.¹⁸ On the other hand, the non oil exporting rich countries, such as China, also saw their national dollar reserves accumulate due to favorable exchange rates.¹⁹

E - Reasons for the creation of a sovereign fund

These countries have very pertinent reasons to want to invest their surplus in sovereign funds; it can be to diversify their wealth, or to secure a “*healthy/solid*” return on investment. In

¹⁵ MARKHEIM, supra note 11.

¹⁶ See MARKHEIM, supra note 11; See also TESLIK supra note 3.

¹⁷ TESLIK, supra note 3.

¹⁸ See Id.

¹⁹ See Id.

some countries the wealth depends on the export of cyclic or extinguishable raw material such as oil or diamond,²⁰ while in others, wealth may be generated by an advantageous foreign exchange rates.²¹ Both categories may want to look for long term investments to save income for future generations, and diversify their assets by reducing the accumulation of liquidity so as to counter act currency and/or commodity price instability. The need for diversification is particularly relevant now with the falling of the value of the dollar. These considerations drove these countries to reduce their currency reserves and look to invest their surplus in other fields.²² On the other hand, in some developed countries, the surplus generated by tax collection or social security or government pension funds is invested with the purpose of “supplementing the future means of financing social security or governmental pension programs.”²³ Therefore, the growth of sovereign funds is largely accounted to the need to diversify wealth away from currency instability,²⁴ and “preserve and accumulate reserves for future generations.”²⁵

But there are concerns that the motivations behind some of these funds could be illegitimate, such as to advance political or economic agendas and have an impact on the country in which they are investing, or be used for other illegitimate purposes such as to expropriate technology.²⁶

²⁰ Such as Abu Dhabi and Kuwait. See ANDERS ASLUND, *the truth about Sovereign Wealth Funds*, Foreign Policy (posted on December 2007), http://www.foreignpolicy/story/cms.php?story_id=4056. (hereafter ASLUND)

²¹ Such as Singapore, China and Korea. See ALVAREZ, supra note 2.

²² See TESLIK, supra note 3.

²³ Such as France, Australia, New Zealand. See ALVAREZ, supra note 2.

²⁴ See TESLIK, supra note 3; See also, JOSHUA AIZENMAN and REUVEN GLICK, *Sovereign Wealth Funds: Stumbling Blocks or Stepping Stones to Financial Globalization?*, Economic Research and Data, THE FEDERAL RESERVE BANK OF SAN FRANCISCO, FRBSF Economic Letter, 2007-38 (December 14, 2007). <http://www.frbsf.org/publications/economics/letter/2007/el2007-38.html>. (Hereafter AIZENMAN and GLICK).

²⁵ See ALVAREZ, supra note 2.

²⁶ See MARKHEIM, supra note 11.

F – Investment strategies of the Sovereign Funds

It is not possible to have a precise chart about the fields of investment of the Sovereign Funds because they do not publically disclose their financial activities.²⁷ Most governmental investments are conservative, safe, and “readily available to monetary authorities to meet balance of payments needs.”²⁸ By contrast, Sovereign Wealth Funds typically look for riskier investment with high rate return. They are usually long term investments that are not expected to be withdrawn due to short term market volatility.²⁹ The Sovereign Wealth Funds use available funds for their investments and generally do not borrow for it; they are not highly leveraged.³⁰

Generally, they have no specific limitations concerning the fields of the investment that remain very diversified including government bonds, corporate bonds, equity, commodities, real estate, derivatives, and foreign direct investment.³¹ Nevertheless, some Islamic countries obey to Shariha law in their investment and they do not invest for example in companies dealing with alcohol or pornography, nor do they invest in financial institutions not compliant with Islamic Finance. China, on the other hand, keeps away from controversial fields such as transportation, energy and telecommunication.³²

The size of the investment varies a lot; while some countries limit themselves to small portfolio investments not exceeding 10 percent of the voting shares of a corporation (such as Norway), others, such as Singapore, acquire a “substantial” participation in selected industries.³³

²⁷ Id. TESLIK. See also AIZENMAN and GLICK, supra note 24.

²⁸ AIZENMAN and GLICK, supra note 24.

²⁹ See TESLIK supra note 3.

³⁰ Id.

³¹ See AIZENMAN and GLICK, supra note 24.

³² See MARKHEIM, supra note 11.

³³ See ALVAREZ, supra note 2.

China on the other hand is investing also through intermediary as a consequence of acquiring \$3Billion stake in Blackstone Group.³⁴

II – BENEFITS of the SWF

Sovereign Wealth Funds represent significant benefits to the country in which they invest as well as to the country that has them. In the investing country, SWF could lead to “tax cuts, better public works, and stronger state-run businesses.”³⁵ It can also, as was previously said, provide a diversification in the investing country’s assets and a protection from the exchange rate volatility and from the downs of the market.

The benefits of the SWF are not limited to the investing country; they are also extremely beneficial to the country where the investment is made. The liquidity they supply participates in “raising asset prices, and lowering borrowing yields.”³⁶ SWFs, in principle, are not highly leveraged and they are long-term investors. Therefore, when the market faces short term volatility or decreases in prices, SWF are not likely to withdraw their investment as private funds may do.³⁷ That leads to stability in the market, because during critical times, withdrawal of large investors from the market may lead to a crash. In the United States for example, in the absence of these funds invested in the financial market the present subprime crisis would have been worse.

³⁴ See AIZENMAN and GLICK, *supra* note 24.

³⁵ TESLIK, *supra* note 3.

³⁶ See ROBERT M. KIMMITT, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, From *Foreign Affairs* (January/February 2008). <http://www.foreignaffairs.org/20080101faessay87109-p40/robert-m-kimmitt/public-footprints-in-private-markets.html>. (Hereafter KIMMITT).

³⁷ See. *Id.*

It could have meant “a complete collapse of major industry players which would cause catastrophic effects throughout the economy.”³⁸

The injection of foreign capital into a country also “helps expand businesses and finance the current account deficit. The business competition that results leads to a decrease in the price of goods and services, an increase in their availability and variety as well as in the productivity and efficiency of domestic businesses.”³⁹ This business expansion, also leads to more jobs opportunity and to a higher living standard in the country where the SWF are investing.

Sovereign wealth funds are so beneficial for the country where they invest that many governments are actually soliciting and pursuing governments having SWF to invest in their countries without putting any conditions on them. For instance “Sweden’s Financial Markets Minister said the Swedish Government will target Persian Gulf sovereign wealth funds” he added that “Sweden has ‘companies for sale’ and hopes sovereign wealth funds ‘are looking.’”⁴⁰

Usually these funds are non controlling investment; they repeatedly emphasized in press releases that they do not seek control of the companies in which they invest.⁴¹ And that all they were after was the financial income of their investment. So why are some countries, such as the United States, Germany and France so concerned about these funds, and look for ways to regulate them at the risk of driving them away?

³⁸ RON PAUL, *Don’t Fear Sovereign Wealth Funds*, Hearing Before the Financial Services Committee, Joint Subcommittee Hearing, HR 5512 (March 5, 2008). <http://www.lewrockwell.com/paul/paul441.html>.

³⁹ KIMMITT, *supra* note 36.

⁴⁰ *Sweden to target Gulf Sovereign wealth funds*, Middle East Finance and Economy News Wire, February 26, 2008. Pulled out from Lexis Nexis.

⁴¹ *See* ALVAREZ, *supra* note 2.

III - ISSUES ROSE BY SWF

Despite the benefits of the sovereign wealth funds, their size and growth are creating great concerns among the countries that are exposed to them, mostly because of their ability to influence the markets as well as for the possibility of them having a political incentive rather than an economic and financial one. That ability to “make a difference” is mostly due to their extensive interest in the financial market. Although these Funds are not suspected of any responsibility in the actual financial crises, experts say that they could have a role in the future.⁴² The concerns are mainly focused on issues of “corporate governance, transparency and financial market openness.”⁴³

A – Size and rapid growth

Some argue that these funds are not large enough to have an influence over the world’s economy, but others think that their ability to influence various asset markets expands with the expansion of their size and importance.⁴⁴ It is also argued that their actual size could be large enough to “destabilize financial markets.”⁴⁵ The later position is fostered by the fact that these funds are foreseen to reach \$17.5 trillion in 10 years according to a study conducted by Morgan Stanley.⁴⁶

⁴² See STEVEN R. WEISMAN, *Concern About ‘Sovereign Wealth Funds’ Spreads to Washington*, International Herald Tribune, Business section (August 20, 2007). <http://www.ihf.com/articles/2007/08/20/business/wealth.php>. (hereafter WEISMAN).

⁴³ See MARKHEIM, *supra* note 11.

⁴⁴ See WIKIPEDIA, *supra* note 1.

⁴⁵ AIZENMAN and GLICK, *supra* note 24.

⁴⁶ Cited in STEVEN R. WEISMAN, *supra* note 42.

B - Lack of transparency

One main issue concerning SWF is their opacity. Governments do not like to disclose how they are using their money.⁴⁷ Non disclosure can be a question of “tradition” according to M. Gao, the CEO of the most recent Chinese SWF, as he stated in an interview on April, 6th, 2008 on CBS on 60’. Non disclosure can also be for commercial purposes so as not to put SWF in a disadvantageous competition position towards hedge funds and private equity firm who are not required the same level of disclosure.⁴⁸ But requirement of transparency and disclosure cannot be the same for SWF and funds owned by the private sector. Because on the one hand, in the private sector the regulation is mainly to protect investors, creditors and other contracting parties with the private funds.⁴⁹ On the other hand, transparency of the SWF involves issues concerning the interest of a Nation (the recipient Nation) in its national security and economic soundness.

This lack of transparency of SWF raises several concerns: Some are concerned that the reason for the creation of the investment would be for the establishment of a political or economic agenda instead of being for financial commercial purposes. That possibility is particularly worrisome when the investment involves a foreign sovereign entity taking control of “strategically important industries”⁵⁰.

⁴⁷ See MARKHEIM, *supra* note 11.

⁴⁸ See BOB DAVIS, *US Pushes Sovereign Funds to Open to Outside Scrutiny: Treasury has talks with Abu Dhabi, seeks set of rules*, YaleGlobalOnLine (March 3, 2008). <http://yaleglobal.yale.edu/display.article?id=10446>; also M. GAO’s interview on April, 6th, 2008 on CBS on 60’

⁴⁹ KIMMITT, *supra* note 36.

⁵⁰ WIKIPEDIA, *supra* note 1.

C- The use of SWF for manipulation purposes

The Norwegian SWF, which is considered as a model of transparency and disclosure, has taken a political position by recently withdrawing its investment in Wal-Mart on the basis that the corporation violated child-labor laws and prevented employees from unionizing.⁵¹ Despite the fact that NGO's, civil society organizations, groups of shareholders, and even the media have often exercised pressure on corporations to get them to change their policies in certain circumstances (i.e. Nike also for child labor), the impact of such a behavior is completely different when it involves sovereign governments. The lack of transparency and disclosure of China and the Middle East concerning their activities with the SWF raises many concerns. Experts wonder, for example, what would happen if "China took over a U.S. pharmaceutical company and pressed for changes in prescription drug programs [or] if an Arab government demanded a bailout or tax break for its company in return for supporting peace talks in Iraq or Israel?"⁵²

Some showed concern that SWF "band" together, misusing "shareholder's activism." In ordinary corporate governance shareholder's activism could be very beneficial to the corporation because usually shareholders' main purpose in being active in the governance of the corporation is to maximizing the value of their shares. But that may be very different when the shareholders are sovereign countries. They could misuse the power they have as shareholders for political purposes instead of using their powers for the benefit of the corporation.⁵³

⁵¹ See WEISMAN, supra note 42.

⁵² See WEISMAN, supra note 42.

⁵³ See TESLIK, supra note 3.

There are also a lot of concerns that Sovereign Wealth Funds “may ultimately destabilize the global financial system.”⁵⁴ Because of their growing size the withdrawal of their investment from a market can have dramatic consequences on a particular market. The danger of SWF destabilizing the financial system was also addressed by Kimmitt that emphasized the risk of “price volatility” that could occur as a result of a “sudden shift by SWFs in illiquid markets.”⁵⁵ He also pointed out that the non-disclosure of these funds of their investment strategies can cause the market to react to “mere rumors of SWF shifts.”⁵⁶

D – The Investment in the US financial institutions

As a result of their affectation by the actual credit crisis, the investment banks and private equity firms are reducing their involvement in the deal making. SWF have an opportunity to fill the gap. SWF and in particular, the Gulf funds for instance are showing a growing recent interest in the idea:⁵⁷ the Abu Dhabi investment Authority for example, invested \$7.5 Billion in Citygroup,⁵⁸ and \$1.35 billion in the private equity giant Carlyle Group.⁵⁹ China on the other hand acquired a stake in Blackstone.⁶⁰ By buying stake in investment companies, sovereign funds can control the investing policies of these companies by threatening to withdraw their investment. At the same time, their investment would be subject to less scrutiny because it would be shielded by the investment company itself.

⁵⁴ AIZENMAN and GLICK, *supra* note 24.

⁵⁵ KIMMITT, *supra* note 36.

⁵⁶ *Id.*

⁵⁷ EMILY THORNTON and STANLEY REED, *Who's Afraid of Mideast Money?* Business week, January 10, 2008. (Hereafter, THORNTON and REED)

⁵⁸ *See* AIZENMAN and GLICK, *supra* note 24.

⁵⁹ THORNTON and REED, *supra* note 57.

⁶⁰ TESLIK, *supra* note 3.

The recent interest of the Gulf funds in the leveraged buyouts, and the speed of their moves into the private equity field are worrying Wall Street veterans. The funds are taking a great risk by getting a management role in a troubled financial situation when they have a relatively limited experience in managing companies.⁶¹ That minimal level of experience is evident from the low amount of compensation they are willing to pay “top management talent” which makes it hard for them to hire and keep competent people.⁶² Therefore, the concern of SWF destabilizing the financial system is not getting any lesser now that they are widely investing in financial institutions.

E- The unfair competition between SWF and private funds

Sovereign Wealth Funds raise also concerns about unfair competition with the private market. They could use their governmental agencies to obtain information that would not be available to private investors, or use their influence to obtain credit facilities not available to the private sector, thus creating an unfair competitive advantage.⁶³

F. The National Security concern.

Sovereign Wealth Funds can also raise “national security” concerns if the purpose of the investment is to secure control of strategically-important industries for political rather than financial gain. “The worry is that, beyond the possibility of foreign funds pushing up prices on bonds, stocks and real estate, they might exercise inappropriate control politically or in the private sphere.”⁶⁴ Therefore, countries receiving money from the SWF need to remain aware of the risks a sovereign investor can represent to their national security. That risk would be present

⁶¹ THORNTON and REED, *supra* note 57.

⁶² *See Id.*

⁶³ *See* KIMMITT, *supra* note 36.

⁶⁴ *See* WEISMAN, *supra* note 42.

each time the SWF would go beyond a passive investment, whether by acquiring controlling shares in the host company or by “seeking board seats or outsized voting rights.”⁶⁵ As a protection to that threat, proper regulations should be addressed that would not create unnecessary limitations to “an open economy.”⁶⁶

G - SWF and democracy

Sovereign Funds are mostly found in semi-democratic regimes where the population has no chance of stating an opinion and being heard by its government. From the point of view of the population of the countries that have them, SWF may not be such a great bargain. Why would people prefer to have that money in the hands of the government to invest on their behalf rather than have them invest it directly, or have the money disbursed to them directly in way of cutting taxes for example? This concern is particularly acute because the risk of theft is prominent in this field; In Russia, for instance, the minister of Finance has been arrested for embezzling \$43 million from the “stabilization funds.”⁶⁷ In the few democratic countries where these funds are available they were the main reason for which the “incumbent government” could not keep their seats.⁶⁸

IV – HOW TO ADDRESS THE CONCERNS

In light of the benefits of the sovereign funds particularly and the need for their money in period of economic crisis, how should we address the concerns they raise? In the uncertainty concerning whether the benefits of allowing Foreign Investment Funds supersedes the risk those funds represent to the economic stability and national security, some countries such as France

⁶⁵ KIMMITT, *supra* note 36.

⁶⁶ *Id.*

⁶⁷ *See* ASLUND, *supra* note 20.

⁶⁸ *Id.*

and Germany, decided to take measures to block this kind of investment.⁶⁹ But in countries, such as the United States, where the policy is to promote the open market, there is a need to balance the economic security that these funds provide with the concerns of national security that they raise.⁷⁰ Because, the biggest threat to the benefits of foreign direct investment would be a slide toward investment protectionism.⁷¹ These funds are aggressively investing, and the United States should not be “too protectionist about such investments” otherwise this money will turn away.⁷² Imposing restrictions on the oil-rich countries and other non-commodity SWF in reinvesting their money could “lead to a breakdown of the system.”⁷³ Because these countries need to process their excess and they do not have “enough financial instruments . . . to put their surplus in,” while, on the other hand the US is in crisis and deeply needs money.⁷⁴ Restrictions imposed during financial crisis already lead to a breakdown in 1930’.⁷⁵

In addition, the investing countries are already not very eager in investing in the US. On the one hand, the fall of the dollar is discouraging countries in holding to their dollars while others are feeling the need to diversify away from the US market in the actual crisis. China’s withdrawal from a planned investment in Citygroup caused some concerns on whether it was still willing to investment in the US market.⁷⁶ On the other hand, Qatar demonstrated its intend to stay away from the volatility of the dollar. So the question is whether the United States can

⁶⁹ See MARKHEIM supra note 11.

⁷⁰ See Id.

⁷¹ KIMMITT, supra note36.

⁷² MARIA BARTIROMO, *interview with Georges Soros: Chairman Soros Fund, THE BUSINESS WEEK -- FACETIME, OCTOBER 22, 2007.* (Hereafter BARTIROMO).

⁷³ Id.

⁷⁴ Id.

⁷⁵ Id.

⁷⁶ See ALVAREZ, supra note 2.

afford, in these times of crisis, to lose access to these funds knowing that “[e]recting barriers to foreign investment would stifle innovation, reduce productivity, undermine economic growth, and cost jobs.”⁷⁷ Can the Congress take the responsibility of driving this money away from the market by enacting drastic protectionist measures that will probably not make “America any safer”?⁷⁸ Some laws and regulations that are actually in place grant a certain protection from the concerns raised by these funds and other measures are suggested.

A- Protective measures already enacted

Some laws and regulations are already enacted in the United States that protects from the danger of control take over. The same threshold for review applies to both investments by SWF and by other foreign or domestic investors for the investment in financial institutions such as banks, bank holding company and saving associations. The requirements are established in three Federal statutes: Bank Holding Company Act (BHC Act), the Change in Bank Control Act (CIBC Act) and the Savings and Loan Holding Company Act.⁷⁹ Although BHC Act specifically excludes investment made by government from its scope, the Board’s position is that “foreign-owned corporations such as sovereign wealth funds are companies” and consequently “any proposed controlling investment in a U.S. bank or bank holding company by a sovereign wealth fund would be subject to Federal Reserve approval,”⁸⁰ provided the investment is large enough to trigger the threshold of review. Therefore a controlling acquisition by a SWF in a financial

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

institution will be subject to evaluation by the Federal Reserve or by an “other appropriate Federal banking agency.”⁸¹

On the other hand, concerns about possible threats to national security by these sovereign funds are evaluated by the President’s Working Group on Financial Markets, by a working group established by the Department of Treasury and by the Committee on Foreign Investment in the United States (CFIUS).⁸² It is noteworthy that the Committee “is cautious about balancing national security to the need of open investment, and about not creating any unnecessary impediment to the participation in the US market.”⁸³ Despite all the concerns investments by sovereign entities are causing in the country the CFIUS is still handling the review of the foreign investments within the 30 day investigation period and none of the transactions that were submitted to the CFIUS in 2006, were blocked.⁸⁴

In 2007, Congress enacted a new CFIUS (Foreign Investment and National Security Act (FINSIA)) for a higher level of scrutiny and clearance for investments involving an acquisition of control by a foreign government. To determine the impact of a transaction on national security the President or CFIUS will consider whether it concerns sensitive military technology or major U.S. energy assets.⁸⁵ And in January 2008, President Bush issued an Executive Order confirming the “unequivocal support” of the United States to international investment within the need to protect national security.⁸⁶

⁸¹ *Id.*

⁸² *See* MARKHEIM, *supra* note 11.

⁸³ KIMMITT, *supra* note 36.

⁸⁴ *Id.*

⁸⁵ *See* MARKHEIM, *supra* note 11.

⁸⁶ *See* *Id.*

B - Proposed measures

For the purpose of protecting national security, additional measures are necessary. In his interview by Ms. Bartimoro, M. Soros stated that “SWF should be allowed to invest, once they become transparent, for the system . . . to survive.”⁸⁷ Imposing transparency on these funds seems to be a common request to many.⁸⁸ But collecting information and monitoring the sovereign wealth funds to conduct a “transparency test” is an expensive measure, therefore it has little chance of succeeding.⁸⁹ It would best succeed if it was upheld voluntarily by the states owning Sovereign Funds. Consequently, there is an increasing pressure on the SWF to adopt “voluntary code of conduct.”⁹⁰

The US Treasury suggested that the World Bank and International Monetary Fund overlook the Sovereign Wealth Funds and establish “Best Practice Guidelines.”⁹¹ The guidelines would cover the structure and organization of the SWF, the modality of investment and disclosure, as well as issues such as governance and transparency.⁹² But it will not be within the mandate of the IMF to define some of the sensitive issues such as “national security,” because it is argued that this notion is best defined by the country that receives the investment. IMF is working on those guidelines, and it hopes to have a draft ready by the fall.⁹³

Meetings were also held between a delegation of the U.S. Treasury and executives from the two largest Sovereign funds, Abu Dhabi and Singapore. In addition to being two of the

⁸⁷ BARTIROMO, supra note 72.

⁸⁸ See AIZENMAN and GLICK, supra note 24.

⁸⁹ See *Id.*

⁹⁰ DAVIS, supra note 48.

⁹¹ See AIZENMAN and GLICK, supra note 24.

⁹² See DAVIS, supra note 48.

⁹³ *Id.*

largest SWF, those two funds have also the advantage of representing two different sources of capital; while the first generates its income from oil, the second generates it from export revenue. Despite their ranking at the top of the scale of sovereign wealth funds, they are respectively ranked last and third to last in a ranking for openness of 32 sovereign-funds by Ted Truman. The purpose of the meeting was to set the basis to an agreement concerning the behavior of such funds and get them to pledge not to use their investment for political purposes. While convincing them of the need for the regulation, prudence had to be shown not to risk having them lose their interest in investing at a moment where their money is strongly needed. Reaching an agreement with those two principal sovereign funds concerning transparency would have encouraged other sovereign funds to do so.⁹⁴ But a representative of the Singapore sovereign fund said that they might agree on disclosing the rate of their return on investment and the objective of their investment but not the purchases it makes otherwise they may become “at a competitive disadvantage [towards] hedge funds and private equity funds.”⁹⁵

A code of conduct imposing duties on both the host country and the investing country was proposed by Robert Kimmitt.⁹⁶ According to Kimmitt, recipients of SWF investments should avoid protectionism regardless of whether the investor holds a controlling interest in national firms. They should also uphold fair and transparent investment frameworks by having publicized, clearly articulated, predictable and non discriminatory investment policies and processes, especially those concerning national security. Within that framework, they should respect the investor’s decisions and choices of investments especially in the light of the risk of

⁹⁴ *Id.*

⁹⁵ *See Id.*

⁹⁶ KIMMITT, *supra* note 36.

losses. Finally, they should treat investors similarly to domestic entities in respect to taxes and regulations.

On the other hand, Kimmitt considers that the SWFs should follow five rules for a sound investment. First, they should have a formal statement as part of their investment management policies that they invest commercially, not politically, and that their investment decisions are solely based on economic considerations. Second, they should be transparent about their investment policies and have strong risk-management systems, governance structures, and internal controls. Third, they should compete fairly with the private sector, including “by financing acquisitions at below-market rates.” Fourth, they should “promote international financial stability” by communicating effectively with the official sector to address financial-market issues particularly during times of market stress. Finally, they should respect host-country rules including disclosure requirements.

Sometimes disclosures can be made voluntary if the circumstances impose them. Dubai, for instance, had to give access to its statements to financing institutions because it needed to borrow money for the purpose of recent deals. And now, it is hoped that Abu Dhabi would follow the lead of its neighbor.⁹⁷

If a voluntary solution to the problem of disclosure and transparency is not adopted by SWF, the recipient countries will have to enact legislations to regulate the investment of Sovereign Wealth Funds.⁹⁸

⁹⁷ See DAVIS, *supra* note 48.

⁹⁸ See *Id.*

It is noteworthy, that whatever is the solution that is adopted, it has to have implementation measures, otherwise that would be an impediment to the success of any attempt to regulate Sovereign Wealth Funds.

V – CONCLUSION

SWF should comply with transparency and to a voluntary code of conduct. But, in the light of the actual economic situation in the United States, there is a real danger in implementing a heavy regulation for protectionism purposes. That would most certainly drive these pools of money, heavily needed in the economy, away from the US market. Therefore the measures to be taken have to be very carefully weighted in order to balance the concerns of security with the need for the funds.