LEVERAGING INTERNATIONAL LAW TO INCENTIVIZE VALUE-ADDED SHAREHOLDING: WHY FOREIGN SOVEREIGN WEALTH FUNDS STILL MATTER AND HOW THEY CAN IMPROVE SHAREHOLDER GOVERNANCE

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ABSTRACT

Rhetoric surrounding foreign sovereign wealth funds (SWFs) has reflected a swinging pendulum: from a fear of SWFs actively investing based on political motivations, to a fear of SWFs passively sinking into institutional apathy. This Note examines empirical information about SWF investment behavior in the post-financial crisis world and proposes a solution to yield a value-enhancing middle ground. This Note argues that when SWFs behave like responsibly active shareholders, their behavior is value-maximizing for the firm in which they invest. However, in order to ensure that SWF shareholders remain responsibly active, SWFs must be more transparent. Such transparency can be achieved by harnessing international law mechanisms to incentivize transparent SWF investment.

I. INTRODUCTION .................................... 948
II. WHAT IS A SOVEREIGN WEALTH FUND? ................... 951
III. POLICYMAKERS AND THE FEAR OF SWF ACTIVISM ............ 954
IV. TENSION BETWEEN FEAR AND THE BENEFITS OF ACTIVE INSTITUTIONAL INVESTORS ............................ 959
V. TRANSPARENCY AND ACTIVENESS ........................ 964
A. Proxy Voting and Shareholder Proposals ................... 965
B. Assessing Independence ................................... 966
C. Disclosure ........................................... 967
VI. ENCOURAGING TEMPERED ACTIVISM AND REASONABLE DISCLOSURE BY HARNESSING INTERNATIONAL LAW ........... 968
A. Improving the Santiago Principles ....................... 969

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I. INTRODUCTION

“The relationship between international politics and international investment is an issue as old as commerce.”

Coca Cola, Visa, Apple, Bank of America, and Johnson & Johnson are as American as apple pie. Coincidentally, they are also partially owned by China’s sovereign wealth fund (SWF) and are some of its $9.6 billion share in U.S. traded companies. In 2008, Western companies appeared to be surrounded by foreign investors—Qatar’s Sovereign Investment Fund purchased a twenty percent share in the London Stock Exchange; entities in Singapore and Abu Dhabi purchased a $14.4 billion share of Citigroup; and Singapore’s Sovereign Wealth Fund (SWF) and entities in Kuwait and Korea purchased a $10 billion share of Merrill Lynch. Pundits wondered: what was this foreign economic invasion?

These transactions paralleled controversial acquisitions by state-owned companies. In 2005, the U.S. Congress blocked the Chinese National Overseas Oil Company’s acquisition of Unocal. In 2006, popular opposition pressured Congress to block Dubai World Ports’ acquisition of port facility operating rights. Neither of these proposed transactions involved an SWF, but the backlash against foreign-state involvement in U.S. companies spread like a wildfire. In the spring of 2007, the controversy seemed to hit a new high. Blackstone, a large American private equity company was nearing its high-profile initial public offering (IPO). As a final twist before the IPO, a Chinese state-owned investment company purchased $3 billion in non-voting

5. Id.
equity shares.\textsuperscript{6} This high-profile purchase triggered a strong public response.\textsuperscript{7}

Unsurprisingly, in 2008 and 2009, as investments increased, SWFs were widely discussed among scholars, investors, and politicians.\textsuperscript{8} However, since their debutante ball starting in 2007 and ending in 2009, discussion about SWFs has begun to wane.\textsuperscript{9} During the financial crisis and the peak of the banking system’s vulnerability, SWFs effectively threw a life vest to American banks by purchasing $60 billion in new stock during the subprime mortgage crisis.\textsuperscript{10} As a result of these and other investments, SWFs lost about $80 billion,\textsuperscript{11} or around twenty percent of their asset value in 2008.\textsuperscript{12} Even today, SWFs are more relevant than ever—in 2013, SWFs conducted $36.5 billion worth of deals.\textsuperscript{13} At the end of 2009, the Chinese SWF, China Investment Corporation (CIC), reported holding securities in over sixty different American public companies. SWFs continue to be institutional investors with deep pockets and significant buying power in America and internationally.\textsuperscript{14} But this begs the question: do we trust these entities as shareholders of American companies, and if not, why? Is there a way to incentivize these new global financial actors to behave such that companies benefit on a micro-level and the economy benefits on a macro-level?

\begin{itemize}
\item \textsuperscript{6} Id. at 1.
\item \textsuperscript{7} Bortolotti argues that this transaction marked when “SWFs first entered popular discourse.” Id. at 3.
\item \textsuperscript{10} BORTOLOTTI ET AL., supra note 4, at 1.
\item \textsuperscript{11} Sovereign Funds off to a slow M&A start in 2014, REUTERS (Mar. 17, 2014), http://www.reuters.com/article/2014/03/17/funds-sovereign-deals-idUSL6N0M92K120140317.
\item \textsuperscript{12} Cooke, supra note 8.
\item \textsuperscript{13} Compare to the $73 billion that SWFs invested in 2007, pre-financial crisis. Sovereign Funds off to a slow M&A start in 2014, supra note 11.
\item \textsuperscript{14} “The United States is the most popular target nation for SWFs in terms of both number and total value of investments, accounting for 53.1 percent of the number . . . and 32.1 percent of the total value . . . of SWF investments being channeled to US headquartered publicly listed companies.” Velijok Fotak et al., Financial Role of Sovereign Wealth Funds, in OXFORD HANDBOOK OF CORPORATE GOVERNANCE 581, 588 (Mike Wright et al. eds., 2013).
\end{itemize}
It is undeniable that SWFs are still, and will continue to be, important. Because of rising commodity prices and global imbalances, SWFs will foreseeably continue to grow in relevance and serve as important actors in corporate governance. The global worth of SWFs is estimated to be anywhere between $2.5 trillion and $6 trillion, which is the size of Japan’s GDP. For the sake of perspective, total assets under management of private equity are valued at about $2 trillion, and hedge funds have about $2.6 trillion in assets under management. SWF size is also comparatively concentrated, with the three largest SWFs owning over $1.5 trillion in assets. As such, although interest has waned, SWFs still merit attention.

Investors in companies are able to influence a corporation’s behavior by embracing shareholder democracy. Because SWFs purchase relatively large stakes in private and publicly traded firms, they are extremely capable of influencing boards of directors and affecting corporate governance dynamics in American public and private companies. However, due to their relative novelty, whether SWF’s embrace such power as shareholders is still unclear. As private, foreign entities, information from SWFs themselves is limited; thus, it is hard to clearly ascertain whether SWFs are passive, long-term investors, more active investors, or something in the middle. Thus, the role SWFs play in corporate governance must be assessed by analyzing empirical information and indicators of SWF behavior.

16. Global worth is measured here as aggregate SWF assets.
21. There are several possible reasons as to why SWFs have evaded the limelight, including the following: an improved economy, investors may be used to SWFs in the marketplace, etc. It is this Note’s position that SWFs themselves have not altered the way they invest.
22. Influencing refers to formal influence, via shareholder voting and elections, as well as unofficial influence.
23. Fotak, supra note 14, at 582-83.
This Note argues that when SWFs behave like responsibly active shareholders their behavior is value maximizing for the firm they invest in on a micro-level and, in turn, to the global economy at a macro-level. In order to ensure that SWF shareholders remain responsibly active, SWFs must be more transparent. This Note, therefore, first endeavors to define what constitutes a sovereign wealth fund (Part II) and to describe why unhindered SWF shareholder activism may be undesired (Part III). Next, this Note chronicles the tension between the problems with active investing and the problems with passive investing (Part IV) and proposes a middle ground—responsible activism. Part IV also explains how such tempered active investing improves firm value by closing the monitoring gap and argues that, in order to obtain such benefits, SWFs should become more transparent. The Note then proceeds to analyze transparency and active shareholding indicators including proxy voting (Part V.A), independence (Part V.B), and disclosures (Part V.C). The Note then recommends how international law can be leveraged to address the shortcomings highlighted in Part V and to encourage responsible shareholder activism discussed in Part IV.

Although the goals of this Note appear lofty, the primary goal is to highlight previously un-discussed linkages between SWFs, active investing, microeconomic and macroeconomic value, international law, and transparency. This Note also aims to reanimate discourse about SWFs in a post-financial crisis world where empirical evidence about SWF behavior is more readily available.

II. WHAT IS A SOVEREIGN WEALTH FUND?

Kuwait was one of the first countries to establish a sovereign wealth fund,24 the first domino in a chain of SWF creations that accelerated through the oil price spikes in the 1970s and 1980s.25 In many ways, Kuwait’s experience is emblematic of the rise of SWFs. Kuwait originally sought to harness the profits of non-renewable oil by taking oil income in the present, and making it last into tomorrow, thereby avoiding a “boom and bust” scenario.26 Since Kuwait, many other

24. The island nation of Kiribati was the first to create an SWF to address phosphate revenues. Amy Keller, Sovereign Wealth Funds: Trustworthy Investors or Vehicles of Strategic Ambition? An assessment of the benefits, risks and possible regulation of sovereign wealth funds, 7 GEO. J. L. & PUB. POL’Y 333 (2009).


26. Id. at 5.
countries have established similar investment vehicles, some with similar objectives and some to account for trade surpluses or other volatility-preventing reasons. Between 2005 and 2012, over thirty-two SWFs were established.  

Most SWFs are located in oil- or resource-rich countries where fiscal surpluses or balance of payments surpluses exist.

As SWFs have grown in size they have also grown into diverse forms—many have come to realize that SWFs are an amorphous concept without a single definition to provide clarity. Generally speaking, SWFs can be defined as “funds established, owned and operated by local or central governments, [and] which investment strategies include [the] acquisition of equity interests in companies listed on international markets.” The fund itself is a pool of money or assets from the country’s reserves established for policy reasons and invested domestically or abroad in the private marketplace.

Some scholars attempt to elucidate the boundaries of what is and is not an SWF. For example, the Monitor Company Group has argued for specific definitional requirements for an SWF, which include the following: direct sovereign government ownership, independent management, no explicit pension obligations, and investment in assets for economic returns, usually abroad. Other scholars, such as Paul Rose, have embraced the lack of definitional consensus and advocated for an ad hoc fact-based test instead of a categorization approach to defining SWFs. Still others, such as Velijok Fotak, contend that SWFs are those private investment entities that exist in order to avoid the inefficiencies that are inherent in state ownership. This Note employs a more flexible, fact-based approach to SWF definitions.

Whichever definition is used, SWFs have certain undeniable characteristic qualities, including the following: SWFs tend to act as investment vehicles seeking commercial return; SWFs have pools of capital

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28. This includes Arab Gulf countries, Norway, and Ex-Soviet Republics. Fotak, supra note 14, at 583; see also What is a Sovereign Wealth Fund?, supra note 27.


32. Rose, supra note 29 (“SWF investment, and the regulation of those investments, are best understood within a fluid and dynamic political environment.”).

33. Fotak, supra note 14, at 582-83.
that are wholly owned by a government, but are simultaneously organized separately from the central government’s official reserves to avoid invasive government involvement; and SWFs fall within a class of investors called “institutional investors,” which include pension funds, mutual funds, and hedge funds. In addition, SWFs tend to be long-term investors, meaning they invest over an indefinite period of time—for example, Australia’s SWF measures performance over a ten-year period. Lastly, SWFs “hold diversified portfolios that ‘range across equity, fixed income, real estate, bank deposits, and alternative investments such as hedge funds and private equity.’”

Institutions and scholars have sought to categorize SWFs. SWFs can be classified by the source of their sovereign wealth and by their objectives. The International Monetary Fund’s (IMF) classification seems the most widely accepted and breaks SWFs into the following groups:

(1) stabilization funds designed to insulate the budget or the economy against price swings [for example Iran, Norway, and Russia’s SWFs]; (2) savings funds for future generations often transferring wealth that is underground into financial wealth above ground [for example, Abu Dhabi’s Investment Fund, and Libya’s SWF]; (3) reserve investment funds that are an adjunct to other arrangements for managing foreign exchange reserves and sometimes include a portion of the country’s foreign exchange reserves [for example China and Singapore’s SWFs]; (4) development funds that are organized to achieve various socioeconomic objectives at home or abroad and may resemble financial holding companies [for example UAE’s and Iran’s SWFs]; and (5) contingent pension reserve funds that are intended to backstop government pension funds [for example Australia’s and New Zealand’s SWF].

34. Id. at 584.
38. Edwin M. Truman, Sovereign Wealth Funds: Threat or Salvation? (Peterson Institute for International Economics, 2010); see also Monetary and Capital Markets Dep’t, Policy Dev.
The objective of an SWF drives the fund’s investment strategy, affects priorities (preservation of wealth versus diversification and growth), and influences the fund’s affinity for risk and management. Ultimately, policymakers tend to overlook many of the characteristics of SWFs that incentivize SWFs to be passive investors. For example, many SWFs pursue the portfolio management investment approach, which involves diversifying investments by investing small amounts in many companies and focusing on benchmark indexes. Investors that focus on index returns tend to pay less attention to individual firms and consequently conduct less monitoring and participate less actively in individual outcomes. Regardless, fear of SWF activism is alive and well.

III. POLICYMAKERS AND THE FEAR OF SWF ACTIVISM

“Were China’s [Sovereign Wealth] fund so inclined, it could buy Ford, G.M., Volkswagen, and Honda, and still have a little money left over for ice cream.”

Capitalism relies on the underlying belief that shareowners aim to maximize share value. Corporate governance scholars prize shareholder primacy, which focuses on the premise that shareholders do and should exercise shareholder rights to maximize the value of the firm as a shared objective. In the case of SWFs, however, the fear is that these foreign, secretive, government-owned entities aim to exercise shareholder rights to promote nationalist goals as tools in foreign policy and as extensions of the state. In lieu of value maximization, politicians worry that SWFs will act to advance their government’s interests by acting as a government appendage. One scholar has...
asserted that this advancement “calls into question our most basic assumptions about the structure and functioning of our economies and the international financial system.”45 Policymakers see that sovereign wealth funds have grown by 59.1% between 2008 and the end of 201246 and are cognizant of a general trend of increased government ownership of publicly traded companies.47 These realities combine to create an environment of SWF distrustfulness and paranoia. This paranoia persists today. For example, in 2013, U.S. officials communicated to CIC, one of China’s SWFs, that it could not invest in a Washington State toll road, and the mayor of the city declared that many politicians perceived Chinese money as suspicious.48

As a result, many have expressed concern about SWFs engaging in active investing or using their ownership position to actively push for governance changes.49 As opposed to other potentially politically motivated activist investors such as hedge funds, socially responsible investment funds, and union-backed pension funds,50 policymakers fear that SWFs will act politically against the interests of the United States. Even more troubling, seven of the ten largest SWFs are from non-democratic countries with comparatively limited government accountability, such as Algeria, China, Kuwait, Libya, Qatar, Saudi Arabia, and the United Arab Emirates.51 These countries are guaranteed to have some political or economic conflicts of interest with the company’s host country, the United States.52 Instead of merely investing for economic gain, SWFs may use those investments as political or economic tools, thereby blurring the line between government and private sector investors.

46. Fernandes, supra note 25.
47. Fotak, supra note 14.
49. See Larcker & Tayan, supra note 41.
52. Truman, supra note 38, at 33.
What would this political activity look like? Political objectives could involve using investor status and access to the board to steal technology from companies and then transfer said know-how to their own state for geopolitical uses. SWFs could also encourage a company to invest directly in their home country by influencing the board, or even use investments in American companies generally as a “bargaining chip” with the U.S. government, triggering national security concerns. Illustrated in a different context, China’s State Administration of Foreign Exchange purchased $300 million in bonds from Costa Rica on the guarantee that the country would alter its diplomatic recognition of Taiwan. One scholar characterized the fear of politicization in a nutshell:

SWFs are often accused of acting as stalking horses for the governments that own them, and trying to impose non-value-maximizing objectives on target firms. These objectives could be purely political, such as forcing the firm to trade with a home country state-owned enterprise or refraining from doing business with or in a country hostile to the fund’s government (i.e. Israel or Taiwan). Similarly the objectives could be strategic, such as pushing investment targets to take actions that are suboptimal from a wealth-maximization perspective but which further the goals of the state, like favoring the development of specific sectors or reducing unemployment through targeted investment. Alternatively, SWFs could simply use their large stake to tunnel wealth out of the target company, harming the firm’s other shareholders.

The nature of this fear is two-fold: official and unofficial influence. Policymakers are concerned that SWFs will use their official role as a block-holding investor, or an investor holding an ownership position of at least one percent of the company to influence the corporation

53. Many of these fears are offset by federal and state laws. For example, were an SWF to successfully elect a board member to the board, state laws such as duty of loyalty would restrict such a board member from acting against the interests of the company for the SWF.
54. “Consider the Treasury or Federal Reserve Board faced with a threat by a sovereign to withdraw its billions from U.S. companies unless the Treasury or Federal Reserve adopts a certain policy.” Paul Rose, Sovereigns as Shareholders, 87 N.C. L. Rev. 83, 94-95 (2008).
56. Fotak, supra note 14, at 593-94.
through the proxy voting process.\textsuperscript{57} Although such an ownership block is not necessarily enough to create a controlling stake,\textsuperscript{58} control may still be obtained through unofficial, indirect means of soft power to influence the corporation. Unofficial influence can be exhibited by orally communicating their concerns to other shareholders, withholding votes, voting against management’s proxy items, sponsoring proxy items, and selling shares. Both of these mechanisms could be employed by SWFs in a more expedient, and consequently unsuspecting, manner than other institutional shareholders, because SWFs tend to have fewer internal governance barriers than other institutions and can respond more flexibly.\textsuperscript{59} Additionally, some scholars fear collaboration among SWFs against American interests. The fear is not implausible. SWFs have, after all, worked together in the past, conducting “club transactions” as a unit.\textsuperscript{60} These behaviors are illustrative of active investing that some policymakers fear will be motivated by political, rather than economic, ambitions.

Policymakers that believe that SWFs are active investors point to several concrete examples of SWF active investment. One of these examples is the 2012 Xstrata (Xstrata) and Glencore International PLC (Glencore) merger.\textsuperscript{61} Glencore was a holder of thirty-four percent of Xstrata shares and proposed a merger whereby Xstrata shareholders would receive 2.8 shares in Glencore for each Xstrata share. After Xstrata’s board approved the deal, Qatar increased its Xstrata shareholding to twelve percent, which made its vote necessary to approve the

\begin{itemize}
\item \textsuperscript{57} See LARCKER & TAYAN, supra note 41.
\item \textsuperscript{58} In fact, “fewer than a dozen [SWFs] state that their investment strategies involve the acquisition of significant or controlling stakes in companies.” TRUMAN, supra note 38, at 41-43.
\item \textsuperscript{59} See O’Brien, supra note 9.
\item \textsuperscript{60} Id.
\end{itemize}
merger. Qatar used its position to negotiate with Glencore and increase the offer to 3.05 Glencore shares for each Xstrata share.

Further evidence of activeness is evident in several others contexts. The Norwegian Wealth Fund is openly renowned for having an active voice in company ethics. For example, Norway divested from Wal-Mart due to its labor practices in an effort to alter the company’s policies. In some cases the pressure has worked—Norway’s SWF persuaded Monsanto to reduce child labor in India. In addition to ethics, SWFs have also actively sought to change corporate governance or management. Norway’s fund established a specialist governance board last year to allow the fund to advise their investees on ownership issues and strategy recommendations. This has resulted in the Norges Bank Investment Management, the Norwegian SWF, filing numerous shareholder proposals, one of which advocated for separating the role of Chairman and CEO. Singapore’s SWF has advocated for more independent directors in Standard Chartered PLC, in which it holds an eighteen-percent stake. These specific examples, in addition to general studies, point toward activism.

Meanwhile, other policymakers are unable to point to specific evidence of activism and instead claim that SWFs will be active investors in the future or that SWFs have a natural affinity toward activism. Steven M. Davidoff has argued that “as sovereign wealth funds branch out into new industries and gain investing skill, their investments will likely evolve from smaller passive stakes to controlling interests in companies.” The shift to active investing may be from domestic

62. TRUMAN, supra note 38, at 41-43.
63. Slawotsky, supra note 15, at 1256.
64. Ruth Sullivan, Norwegian Wealth Fund Set to Raise Bar on Governance, FIN. TIMES (Sept. 1, 2013, 6:41 AM), http://www.ft.com/intl/cms/s/0/ca0ede56-0fc9-11e3-99e0-00144feabdc0.html#axzz2c5ud7ymU.
67. Slawotsky, supra note 15, at 1241 n.14 (referring to Henry Sender, CIC Set to Boost Stake in Blackstone, FIN. TIMES (Oct. 16, 2008, 8:50 PM), http://www.ft.com/cms/s/0/f5248e2e-9bb8-11dd-ae76-000077b07658.html#axzz5Tuisjyzi (noting that the “phenomenon is likely to be similar to the influences on corporate governance exerted by corporate raiders in the 1980s and hedge funds in the 1990s and 2000s”)).
69. Davidoff, supra note 51.
pressures to obtain certain returns in their capacity as “custodians of their national treasuries” or simply by the allure of politicization.\textsuperscript{70} Most of these fears are not based on reality, but rather are a product of a lack of SWF transparency. SWFs are not required to disclose information about ownership and investment strategy. Disclosures are largely voluntary in nature. For example, assets owned by Government of Singapore Investment Corporation Pte Ltd.’s subsidiaries “are not subject to statutory disclosures” because they are “exempt private companies.”\textsuperscript{71} Without readily available information, SWF operations and investment intentions are muddled. The natural response is suspicion. This Note argues that increased, mandatory transparency not only reduces the perception that SWFs are a threat, but also goes beyond the perception to temper the threat itself. Lifting the veil of secrecy and shining a light on SWF operations will deter SWFs from acting on a political basis for fear of public scrutiny. This may enable SWFs to invoke productive and active shareholder behavior, as explained in Part IV.

IV. TENSION BETWEEN FEAR AND THE BENEFITS OF ACTIVE INSTITUTIONAL INVESTORS

“Unless such responsibilities are [recognized] by major shareholders, companies will indeed increasingly risk floating ‘ownerless in a vacuum.’\textsuperscript{72}”

The fear of active shareholding directly conflicts with the “shareholder-centric” approach to corporate governance today, which states that the primary purpose of the corporation is wealth maximization for shareholders and views shareholder primacy as value enhancing.\textsuperscript{73} Shareholder activism and monitoring is argued to align shareholder and management concerns, thereby reducing agency costs.\textsuperscript{74}

\textsuperscript{70} Slawotsky, supra note 15, at 1249.
\textsuperscript{72} David Walker, Address to the International Forum of Sovereign Wealth Funds in Beijing (May 11, 2011).
\textsuperscript{73} Larcker & Tavan, supra note 41.
Many scholars have advocated in favor of active investing, especially for larger shareholders, such as institutional shareholders. Large shareholders with superior information can affect firm values by signaling others or by monitoring and changing corporate governance for the better.75 Scholars, such as Shleifer and Vishney, have found that large shareholders can enhance firm value because they have the incentives to monitor firm activities.76 The underlying premise is that rational shareholders will only undertake the task of informing themselves on whether a certain proposal enhances value if the potential benefits of undertaking such an endeavor outweigh the costs.77 Large shareholders have a sizeable stake in a company and thus have more to gain if the company grows in value and more to lose if the company drops in value. Moreover, such large institutional shareholders often have more resources and are thus better equipped to manage the costs of monitoring; all together, the benefits of conducting due diligence outweigh the costs of such work for large shareholders.78 Accordingly, as large shareholders, SWFs are uniquely positioned to “hold the management accountable for mistakes and lackluster performance”79 and subsequently empower shareholder rights. Embracing this position and exercising it to effectively monitor management can bring value to the firm, as discussed below, and value to shareholder rights. For example, hedge funds, which are similarly positioned and which have chosen to engage in activism, create significant value for shareholders.80 Moreover, there is no demonstrable empirical data indicating that SWFs would invoke such power to manipulate the market or “serve as a political vehicle.”81

Conversely, passivity can be a bad thing. Passive investors are found to contribute to a governance gap by reducing shareholder monitoring.

75. Dewenter et al., supra note 55, at 256-57.
76. Id.
78. “Their greater access to firm information, coupled with their concentrated voting power, might enable them to more actively monitor the firm’s performance and to make changes in the board’s composition when performance lagged.” Id.
80. Brav et al., supra note 74, at 1730.
82. Throughout this Note, a passive investor “may be defined as a shareholder who is not only disinterested in control but is also not involved in any activities that may affect firm behavior or
and increasing agency costs. Other institutional investors, such as mutual funds, are similarly critiqued for their penchant for passive investment. Scholars point out that institutional investors often employ portfolio investment, as discussed earlier, which involves diversifying investments, thereby negatively incentivizing monitoring and activeness in any single investment endeavor and developing “rational apathy.” SWFs employ similar portfolio investing approaches.

In addition, because SWFs invest over the long term, investor passivity can result in a blank check for management; if dispersed shareholders are disincentivized from keeping management in check and institutional shareholders are apathetic, who will monitor the board? At the 2008 Davos meeting, Larry Summers highlighted his concern that long-term non-voting shareholders such as SWFs may protect bad management and lead to entrenchment. Such “rational reticence” decreases the value of shareholder votes. Because shareholders have two primary tools to influence corporate behavior, voice and exit, passive shareholders diminish shareholder influence over the long term. Ultimately, passive shareholding can also contribute to an agency gap and misaligned interests between the agent (the board) and the owners (the shareholders). Thus, corporate governance needs SWFs to behave more like owners in order to keep the agents in check and maximize firm value. Because studies have shown that long-term investments are not incompatible with responsible active investing, SWFs could hypothetically act with a “sense of owner-


83. MEHRPOUYA ET AL., supra note 66, at 16.
84. Bainbridge, supra note 77.
85. For example, mutual funds are often “reluctant to eject incumbent managers and directors.” Matthew C. Klein, Buy $3 Trillion in Stocks. What Could go Wrong?, BLOOMBERG (Jan. 9, 2014, 4:45 PM), http://www.bloombergview.com/articles/2014-01-08/buy-3-trillion-in-stocks-what-could-go-wrong-.
88. Gilson & Gordon, supra note 74.
89. Rose, supra note 29, at 3.
90. This is why some scholars, such as David Walker, advocate for increased SWF investments as limited partners in private equity, where the agency gap is narrowed because of communication incentives. Walker, supra note 72.
91. For example, the Saudi Prince Al-waleed Bin Talal’s Kingdom Holding Company (KHC) invests long-term but is also known for active investing by “taking investment positions large
ship.” However, SWFs do not seem to be living up to their potential.

Studies indicate mixed results regarding sovereign wealth funds and their contribution to the value of the firm. Some scholars find positive value added to the firm. In a study conducted by Nuno Fernandes, focusing on SWF holdings, the data found that firms with higher SWF ownership operate better and are valued fifteen to twenty percent higher than firms with lower rates of SWF ownership. The studies also found that the market responded positively to SWF investment. One reason for this is, in addition to playing the role of a monitoring large investor and being sufficiently powerful to affect firm management (which Fernandes calls “channels of impact”), SWFs have greater access to firm-value-affecting information and are best able to signal others.

Other scholars find no effect or even negative effects on the value to the firm. Chhaochharia and Laeven conducted a study in 2008 focusing on SWF transactions and found poor long-run performance of the firms SWFs invested in. Another study found that SWFs, as large shareholders, are likely to impose more agency costs on a firm than other institutional investors because of their unclear motives, and such an increase in agency costs leads to a decrease in the value of the firm. A study conducted by Knill found that SWF investment often led to a

enough to give KHC a voice in the strategic management of its portfolio companies.” Rose, supra note 54.

92. Walker, supra note 72; BORTOLOTTI ET AL., supra note 4, at 11-12, 17-19.

93. Fernandes found an upward short-term price response to SWF investment, as well as “longer term improvements in target firm operating performance as measured by higher Tobin’s Q [defined in footnote 96], return on assets, return on equity, and higher operating returns.” Moreover, “the premium for SWF investments is significantly larger than the premium for regular institutional ownership.” BORTOLOTTI ET AL., supra note 4, at 15 (citing Fernandes study, 2009); see also Fernandes, supra note 25.

94. Dewenter et al., supra note 55, at 256. Tobin’s Q is defined as the ratio between the market value of a company divided by the replacement value of the firm’s assets. See DEFINITION OF ‘Q RATIO (TOBIN’S Q RATIO)’, http://www.investopedia.com/terms/q/qratio.asp (last visited May 11, 2014).

95. “If large investors possess superior information, then their transactions will affect firm values through signaling.” Signaling is equivalent to “lobbying by SWF investors against losses.” Dewenter et al., supra note 55, at 256, 258.

96. BORTOLOTTI ET AL., supra note 4, at 15 (citing Vidhi Chhaochharia & Luc Laeven, Sovereign wealth funds: Their investment strategies and performance (International Monetary Fund, Working Paper, 2009)).

The key here though, is the potential for positive value. In fact, a study by the World Economic Forum revealed that sovereign wealth funds with better Truman index scores, a measure of numerous SWF good governance practices (considering structure, governance, transparency, and accountability), have a positive impact on a company’s stock price over time, indicating that well-managed and transparent SWFs are value-adding investors. Thus, transparent SWFs that actually engage in proper monitoring associated with responsible active investment would arguably increase firm value.

Disregarding the different opinions on SWFs and value, studies on both sides tend to agree that, intuitively, two types of SWF investors fail to contribute to firm value: “funds that act as passive investors and active funds suffering from strong internal political interference.” More transparent SWFs are less likely to invest for political reasons, or be influenced by internal political interference, because they are subject to increased visibility. Consequently, more transparent SWFs are also arguably less likely to be completely reticent because they too are subject to increased visibility. Additionally, transparency via disclosure shows other investors and host country regulators the profit-seeking objectives of the fund, thereby increasing confidence in SWF investing, which further increases value-enhancing investment. Therefore, in order to determine whether SWFs contribute to firm value, and thus arguably endeavor to engage in firm value maximization, it is necessary to observe SWF transparency. The rest of this Note will focus on an assessment of transparency indicators—proxy voting, indepen-

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98. Rose, supra note 29, at 12 (citing April M. Knill, Bong-Soo Lee & Nathan Mauck, ‘Sleeping with the Enemy’ or ‘An Ounce of Prevention’: Sovereign Wealth Fund Investments and Market Destabilization 13-16 (2009)).
99. The Truman Index was devised by Edwin Truman, a fellow at the Peterson Institute for International Economics. The index rates 32 of the largest funds and provides scores based on numerous criteria including “structure, governance, transparency and accountability and behavior.” See William L. Watts, Sovereign Wealth Funds Too Big to Ignore, MARKETWATCH (Oct. 20, 2007), http://www.marketwatch.com/story/sovereign-wealth-funds-too-big-to-ignore. A study by Dewenter also found that a higher Truman score may be positively related to long-term target performance, although it was not linked to stock price reactions. Rose, supra note 29, at 11.
102. See Rose, supra note 29, at 14.
103. “SWF investments’ could be viewed as a stabilizing and modernizing influence in global finance.” Cox, supra note 8.
dence, and disclosure—to assess the status of SWF transparency. The Note ends with a recommendation on how to harness responsible SWF activism through the influence of international law.

Whether SWFs are too active, which may be the case with some SWFs, or too passive, which may also be the case with others, the question remains: how can we encourage those funds that remain overly passive to be more active, while simultaneously moderating damaging active engagement? The answer is transparency.

V. TRANSPARENCY AND ACTIVENESS

In 2008, an IMF working group issued a set of international, voluntary principles for SWFs, deemed the Santiago Principles, to advocate for transparency and disclosure. The Principles aim to encourage SWFs to act based on economic factors instead of political motivations. The Santiago Principles push for public disclosure of the source of SWF funds, investment purpose, investment strategy, portfolio and governance structure, and the relationship between the fund and the government. Because the Principles are non-binding, compliance with the code of conduct has been at about sixty percent. Some funds have much higher compliance rates than other SWFs—the Norwegian and Australian SWFs have the highest rates of disclosure. Adherence to the Santiago Principles, in addition to proxy voting and governance patterns, is an effective way to measure SWF transparency, as well as investor activism. Indicators of activism are those that point toward motivations and habits, such as proxy voting and shareholder proposals.

A. Proxy Voting and Shareholder Proposals

The right to vote is a fundamental shareholder right, and studying SWF voting records can reveal the extent of SWF engagement in

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104. The formal name of the Santiago Principles is the International Working Group of Sovereign Wealth Funds’ Generally Accepted Principles and Practices.
105. MEHRPOUYA ET AL., supra note 66.
108. Id.
109. Id. at 61-62.
The role of voting is extremely important in the context of SWFs. Shareholders essentially have three rights—the rights to sue, to sell, and to vote. As long-term investors, SWFs are by nature unlikely to sell. As investors that seek to avoid a political backlash, SWFs may also be hesitant to sue. Consequently, voting may be the SWFs’ only other official method to exert influence on the board.

Gathering data on proxy voting has been difficult. Despite the fact that a majority of funds are subject to some sort of public reporting requirement, few funds are required to disclose, and few do. Thus, disclosures of proxy voting records are largely voluntary, and the dearth of disclosure indicates poor transparency. The Norwegian SWF is the only fund that openly discloses its proxy voting records, and most of the SWFs fail to disclose their general proxy voting strategy. Consequently, little information is available on the matter. SWFs are even hesitant to disclose their general approach to voting, in addition to general engagement policy and performance data for investments. Equally cryptic is the lack of information on the relationship between SWFs and proxy advisory firms such as Institutional Shareholder Services (ISS). Regardless, a 2009 study of the then ten largest SWFs found that most proxy votes were cast in favor of the management’s position, and no blatant active engagement was found. The absence of controversial voting in the study indicates either that the SWFs agreed with management’s proposal or a general tendency to vote with management. Some scholars also argue that such voting is a product of the fear SWFs have that any form of activism may generate a political backlash in the host country.

111. Cf. Sharelene Goff, Libya’s Sovereign Wealth Fund to Sue Goldman over $1bn Trades, Fin. TIMES (Jan. 30, 2014, 1:17 PM), http://www.ft.com/intl/cms/s/0/6321c91a-89a6-11e3-8829-00144eab7de.html#axzz2wolwqFzi (Libya filed suit against Goldman, alleging that the bank “exploited” the SWF and lack of sophistication in advising them to engage in risky investments).
113. Id. at 21-23.
114. See Fernandes, supra note 25.
116. The Mehrpouya study cited throughout the transparency section of this Note was conducted by RiskMetrics Group, Inc., which is the parent company of ISS.
118. Fotak, supra note 14, at 583.
Moreover, the cited study rarely found SWFs seeking or filling a board seat, which would be indicative of an active desire to influence management.\textsuperscript{119} A board presence is usually linked to a fund’s investment strategy. Funds like Singapore’s Temasek tend to purchase larger stakes, while other funds that pursue a portfolio investment approach possess a high number of minority non-controlling stakes.\textsuperscript{120} Of those SWFs with non-controlling stakes (below ten percent), the cited study only found a few examples where the minority SWF held a seat on the board or had put forward a motion to obtain such a seat.\textsuperscript{121} The study’s board presence findings are in line with its shareholder resolution findings. The Mehrpouya study only found a few shareholder resolutions, which would also indicate shareholder activism; those found were mostly pioneered by the Norwegian SWF, which is known for advocating on ethical issues, from Israeli settlements to Myanmar.\textsuperscript{122}

B. Assessing Independence

“[Governments] can’t bring themselves to relinquish control of such large pools of capital, but they also see the need to remove it from political manipulation.”\textsuperscript{123}

Independent SWF entities are more likely to invest without political influence and focus on value-enhancing engagement.\textsuperscript{124} The better access the government of an SWF has to an SWF’s board or management, the more conflicts of interests an SWF will have, and the less independent the SWF can be.\textsuperscript{125} The ideal, independent SWF is one that is incorporated as a private entity (only three of the ten observed in the cited study are independently incorporated).\textsuperscript{126} This model provides institutional protections. Some argue that this is also the most

\textsuperscript{119} Mehrpouya et al., \textit{supra} note 66, at 21-23.

\textsuperscript{120} Id. at 16.

\textsuperscript{121} Id. at 27-32.

\textsuperscript{122} “In 2008, NBIM [the Norwegian SWF] engaged with 16 companies on corporate governance and shareholder rights; with 19 companies on child labor, risk management in the supply chain, and board competence; and with ten companies about their stance on greenhouse gas emissions.” Id. at 26.

\textsuperscript{123} Balding, \textit{supra} note 86, at 13.

\textsuperscript{124} Mehrpouya et al., \textit{supra} note 66, at 61-62.

\textsuperscript{125} To illustrate, some scholars emphasize that hedge funds are ideal activist investors because they have few conflicts of interests. Brav et al., \textit{supra} note 74; see also Mehrpouya et al., \textit{supra} note 66, at 61-62.

\textsuperscript{126} Mehrpouya et al., \textit{supra} note 66, at 61-62.
logical approach to SWFs because SWFs themselves were a product of a realization of the inefficiencies inherent in state ownership. 127 In the cited Mehrpouya study, four of the ten are government agencies essentially connected to the government as a political arm—the opposite of the ideal SWF model. 128 However, even wholly independent SWFs must have a role for the government on the board. Without a majority of independent board members and independence for ordinary course management, however, political pressures may come into play. 129

The best way to offset such internal political pressure is through internal governance mechanisms. Failures to institute clear internal governance procedures lead to government interference, such as when Venezuela’s government “raided” its SWF. 130 Insulating an SWF from politics ensures independence and further encourages value-enhancing shareholder behavior. One strategic way to insulate an SWF is to outsource management to external asset managers. All of the ten SWFs analyzed in the cited study outsource asset management, but at different levels. 131 Despite efforts to insulate an SWF from political intervention, the government will likely always be present in some capacity. For example, several of the funds had some sort of government screening mechanism for the portfolios—to illustrate, Kuwait’s SWF cannot invest in alcohol, gambling, or other activities that contradict the government’s normative religious stance. 132

C. Disclosure

Disclosure bears directly on transparency, which in turn affects SWF behavior. Under the Santiago Principles, funds are advised to disclose the purpose of the fund and the source of the fund’s money, in addition to other governance and investment-policy-related disclosures. 133 In the cited Mehrpouya study, only five of ten funds disclosed their periodic reports to the public. 134 Compliance with disclosure

127. Fotak, supra note 14, at 582-83.
128. In fact, the Russian SWFs which are within the Ministry of Finance are “[the] only two funds that could be considered to be an arm of a national government.” Mehrpouya et al., supra note 66, at 32-37.
129. Id.
130. Fotak, supra note 14, at 593.
131. Mehrpouya et al., supra note 66, at 27-32.
132. Id. at 39.
133. Int’l Working Grp. of Sovereign Wealth Funds, supra note 106.
134. Mehrpouya et al., supra note 66, at 51.
obligations is generally weak. Although all of the funds in the study have stated investment objectives and general strategies, little is revealed about actual investment management. All funds studied disclosed their mission or investment strategy, but once again, disclosure was at a general, unspecific level (and consequently no express national political or economic objective was revealed). Additionally, little to no disclosure was discovered on the desire to seek board seats, which was contrary to actual behavior in some circumstances. Funds also failed to disclose comprehensive financial information and investment policy, which might be a reflection of SWFs not wanting to reveal the breakdown of their portfolios.

There are outliers, however, indicative of hope for improved disclosure in the future. For example, the Norwegian fund has consistently demonstrated expansive disclosure. Moreover, SWFs can look to pension funds as an example; compared to SWFs, pension funds have much higher levels of transparency and much more clearly defined investment strategies and policies. Much of this discrepancy is a result of a different regulatory structure for pension funds.

VI. ENCOURAGING TEMPERED ACTIVISM AND REASONABLE DISCLOSURE BY HARNESSING INTERNATIONAL LAW

Although there is no one-size-fits-all solution to SWF transparency, this Note advocates for a regulatory regime that harnesses international law and incentivizes SWFs to contribute positively to corporate governance by encouraging transparency. First, this Part assesses the weaknesses of the IMF’s Santiago Principles and the other more multilateral approaches to SWF transparency regulation. This Part then proposes a more “minilateral” regulatory approach to SWF transparency regulation and ends by assessing how the United States’ regulatory regime could be better aligned with international regulatory efforts.

135. Id. at 27-32.
136. Id.
137. Id. at 21.
138. Id. at 53.
141. CHRIS BRUMMER, MINILATERALISM: HOW TRADE ALLIANCES, SOFT LAW AND FINANCIAL ENGINEERING ARE REDEFINING ECONOMIC STATECRAFT (2014).
The recommendations below follow Rose’s “two-way street” proposal, which argues that SWFs must become more transparent, while, simultaneously, domestic regulators must be more transparent in how they regulate SWFs. Such an approach builds mutual confidence, legitimacy, and ultimately makes the benefits of responsible active investing outweigh the costs.

A. Improving the Santiago Principles

The Santiago Principles aim to encourage SWFs to behave like “idealized private investors.” The Principles represent soft law policies and practices and are not binding until implemented at the national level. In this vein, they have been equated to *lex mercatoria* or “self-enforceable norms.”

The Principles also exhibit several weaknesses in their drafting. Regulators should consider several revisions to the Santiago Principles to improve compliance. First, several requirements within the terminology must be clarified and quantified, as they are often critiqued for being overly vague. For example, “soundness of governance” must be quantified in order to establish certainty, and “best interests” should be qualified. Second, the Principles should be strategically expanded. For example, scholars have emphasized the need for the Principles to push for disclosure of risk management policies. Third, some aspects of the Principles should be conservatively tailored. For example, proxy voting policy disclosures need not be specific and should be synchronized with the OECD’s Guidelines for Multinational Enterprises and the United Nations Global Compact. The Santiago Principles should also allow for some flexibility, which recognizes the

142. Rose, supra note 29, at 41.
145. Adamson, supra note 35.
146. INT’L WORKING GRP. OF SOVEREIGN WEALTH FUNDS, supra note 106.
heterogeneous nature of SWFs; simultaneously, the Principles should limit the ability of countries to avoid compliance by creating carve-outs.

Enforcement of the Santiago Principles should be made more rigorous and more uniform to prevent regulatory arbitrage. But, as is the case with all non-binding international law, compliance is voluntary and is often strategic or a result of customary international law. The Principles only establish a general framework and do not establish a single regulator charged with implementing and enforcing compliance. However, the IMF, which jointly instituted the Principles with the International Working Group of Sovereign Wealth Funds, is arguably the best positioned to fill an enforcement role on a global level. As a “hard law” institution, the IMF already serves “as the basis for monitoring countries’ commitments to global best practices for the regulation of financial markets.” The IMF has assumed such roles by providing short-term loans conditioned with requirements to ensure international compliance and has also agreed to oversee “new financial regulations drafted by the Financial Stability Forum.” In a 2008 report, the IMF recognized that the “macroeconomic and financial stability implications of SWFs fall squarely in the Fund’s mandate for surveillance and ensuring the effective functioning of the international monetary system.” The IMF report acknowledges that other agencies may be better positioned to address other issues with SWFs but argues

149. For example, the Principles should allow for standards to “be tailored to meet local needs and circumstances. A country searching for a better regulatory framework does not need to start from scratch. Instead, it can both learn from and expound on international best practices and guidelines that reflect broad, cross-border consensus.” BRUMMER, supra note 141, at 97.

150. Lee, supra note 144, at 1140 (the Santiago Principles are often criticized for “carve-outs such that each principle is ‘subject to home country laws, regulations, requirements and obligations”’).


152. Lee, supra note 144, at 1140.


154. “Given its wide membership, mandate and experience, the Fund is well placed to coordinate work on a set of best practices, which would be adopted by SWFs on a voluntary basis.” IMF REPORT, supra note 38, at 23.

155. BRUMMER, supra note 141, at 169.

156. Lee, supra note 144, at 1145 (“For example, one of [the] conditions attached to an IMF loan to Indonesia during the Asian financial crisis of 1997 was that it opened its markets to foreign competition.”).

157. IMF REPORT, supra note 38, at 17.
that the Fund is uniquely apt to conduct bilateral and multilateral surveillance and that the Fund should collect SWF-related statistics.\footnote{158}{Id.}

When the Principles were created, the creators did not expressly associate the Principles with the IMF; however, scholars like Professor Anna Gelpern recognize that the IMF \emph{already} assesses policies implicating SWFs.\footnote{159}{See Anna Gelpern, \textit{A Sovereign Wealth Turn}, (Rutgers Sch. of Law-Newark Research Papers Series, Paper No. 025, 2008), \url{available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1272395}.} Thus, Gelpern argues that the Santiago Principles “may help establish a new role for the IMF in financial diplomacy.”\footnote{160}{Id.}

In addition to the Santiago Principles, in 2009, the IMF’s International Working Group of Sovereign Wealth Funds created the International Forum of Sovereign Wealth Funds (IFSWF) to serve as a forum for member SWFs to “facilitate an understanding of the Santiago Principles and SWF activities.”\footnote{161}{\textsc{Int’l Forum of Sovereign Wealth Funds, http://ifswf.org (last visited Jan. 15, 2015)}.} The forum currently has twenty-eight members, including the United States.\footnote{162}{\textsc{Members Information, Int’l Forum of Sovereign Wealth Funds, http://ifswf.org/members-info.php (last visited Jan. 15, 2015)}.} Since its creation, the IFSWF has adopted a three-year plan to promote the implementation of the Santiago Principles.\footnote{163}{Press Release, Int’l Forum of Sovereign Wealth Funds, 6th Annual Meeting of the International Forum of Sovereign Wealth Funds (Nov. 20, 2014), \url{available at http://www.ifswf.org/pr/pr23.pdf}.}

Soft law efforts such as these help foster a culture of SWF transparency and emphasize that the Santiago Principles are the universal benchmark by which countries should measure SWF transparency.

\section*{B. Moving Beyond Multilateral Approaches}

Any regulatory efforts must recognize the reality that the “multilateralism characterizing the last fifty years of international economic affairs has been supplanted by an array of more modest and seemingly less ambitious joint ventures.”\footnote{164}{Brummer, supra note 141, at 1.} Professor Chris Brummer has coined this new regime as “minilateralism.”\footnote{165}{Id.} These ad hoc joint ventures exist outside of formal international organizations and include more informal arrangements, such as regional clubs, the G20, trade agreements, and customs unions.\footnote{166}{Id. at 18.} Such minilateral approaches are more respon-
sive and are easier to institute. Despite the fact that these regulatory mechanisms are often not backed by international hard law, “soft law can be backed with market and governmental enforcement mechanisms that can add bite to promises made by countries and their economic ministers or regulators.” Thus, an effective SWF regulatory regime must recognize that incentives are no longer crafted exclusively at a multilateral level, but are largely derived from more informal approaches.

Because the IMF cannot directly ensure compliance with the Santiago Principles, countries should establish creative solutions, such as tying compliance with the Principles to compliance with binding domestic law, or revising bilateral investment treaties to require compliance with the Principles. Countries can also pursue bilateral negotiations and establish agreements to follow the Santiago Principles, similar to the agreements announced by the U.S. Treasury Department in 2008 with Abu Dhabi and Singapore.

C. Domestic Regulatory Reform

Global regulatory efforts are most effective when they are implemented domestically to establish hard law obligations. Ultimately, SWFs are required to comply with the laws of the investor and investee countries. For example, Norway’s Government Pension Fund invests

167. Given the varied and contentious national interests, the nature of financial investment and the fluidity of financial markets, it is difficult to obtain the agreement or consensus necessary for the formation of treaty or customary international law. A regime of hard regulation modeled after the system and agreements of the World Trade Organization will suffer the same disability of non-consensus of its members concerning foreign investment. In the absence of any real consensus on international financial or investment regulation, an alternative regime of international governance by good practices is preferred . . . . SWFs are . . . special purpose investment funds.

Lee, supra note 144, at 1106-07; see also Brummer, supra note 141, at 18.

168. Brummer, supra note 141, at 19.


171. Mehrpooya et al., supra note 66.
pursuant to guidelines issued by Norway’s Ministry of Finance. This Section thus assesses the United States’ legal regime and renders recommendations that apply both to the United States and to other countries implementing global norms.

In the United States, federal regulations generally favor open foreign investment, but occasionally restrict investments based on an investor having foreign investor status. Thus, certain U.S. laws deter SWFs from increasing investments and active monitoring. These laws could be conservatively altered to provide SWFs more flexibility and make the investing environment less restrictive and more in line with global standards. This Section will address the investigations by the Committee on Foreign Investment in the United States (CFIUS) and the U.S. securities laws.

CFIUS is an inter-agency government committee that assesses the national security implications of foreign investments in “controlling” interests in the United States. Thus, CFIUS monitors investments and aims to ensure that any active investing based on deleterious politics will be blocked. CFIUS broadly defines “control” as the direct or indirect power to determine, direct, or decide important matters affecting a company and has been interpreted to be functional and

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174. SWFs in the U.S. tend to avoid purchasing large blocks of shares, but SWFs often do purchase controlling stakes in emerging economies or their own domestic economies. Thus, many have blamed the U.S. regulatory regime for deterring blockholding. See Rose, supra note 29, at 16; see also WILLIAM MIRACKY ET AL., ASSESSING THE RISKS: THE BEHAVIORS OF SOVEREIGN WEALTH FUNDS IN THE GLOBAL ECONOMY 4 (2008), available at http://www.scribd.com/doc/55548065/Monitor-SWF-Report-Final#scribd.

175. The “shareholder primacy” model, discussed in Section III supra, establishes the link between increased investment blocks and active monitoring.

176. “CFIUS operates pursuant to section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (FINSA) (section 721) and as implemented by Executive Order 11858, as amended, and regulations at 31 C.F.R. Part 800.” Resource Center: The Committee on Foreign Investment in the United States (CFIUS), U.S. DEPT OF THE TREASURY (Dec. 20, 2012, 1:37 PM), http://www.treasury.gov/resource-center/international/Pages/Committee-on-Foreign-Investment-in-US.aspx. CFIUS administers the Exon-Florio Amendment which “grants the president authority to block or suspend a merger, acquisition or takeover by a foreign entity if there is ‘credible evidence’ that a ‘foreign interest exercising control might take action that threatens to impair the national security.” Davidoff, supra note 51; see also 50 U.S.C. § 2170(a) (2007).
include informal control. Should CFIUS find such “controlling” behavior, and should they decide that such behavior is a potential national security threat, the Committee could block the transaction. Note, however, that CFIUS often does not investigate transactions of less than ten-percent stock ownership.

The possibility of a CFIUS investigation deters SWFs from engaging in “control” transactions and also incentivizes SWFs to structure transactions in a way that minimizes “political backlash” and transaction costs. As Paul Rose has explained, “SWF passivity is effectively a regulatory design,” and such a design is motivated by a lack of SWF transparency. CFIUS’ expansive interpretation of “control” deters positive “control” behavior that is unrelated to national security. Also, such an over-broad interpretation is arguably not as necessary in a more transparent SWF environment, where disclosures signal whether an SWF intends to act with political intent. As such, this Note recommends narrowing the reach of potential CFIUS reviews. For example, the Committee could narrow what constitutes control or create a bright-line approach. The CFIUS process should also aim to be more transparent. Such transparency would be in line with the Santiago Principles and allow the United States to set an example for compliance. Opaque regulatory systems deter investment because risks become hard to quantify. Moreover, the United States could consider adding exemptions to the CFIUS process for certain SWFs that have

178. See 31 C.F.R. § 800.302(b) (2007).
180. Id.
182. For example, Joel Slawotsky recommends an approach that is similar to the bank Holding Company Act, which holds that a rebuttable presumption of control exists when a party owns over ten percent of the shares. Slawotsky, supra note 15.
183. Although much of the statute provides great discretion to the President, the annual reports should provide more information and disclose why specific transactions were assessed.
complied with the Santiago Principles.\textsuperscript{185} Other countries with similar national-security-related restrictions should also align their regulations with international norms.\textsuperscript{186} SWFs are also subject to U.S. securities regulations, which, among other requirements,\textsuperscript{187} mandate specific disclosures at different ownership thresholds. Under Section 13G or Section 13D of the 1934 Exchange Act, investors with over five percent beneficial ownership\textsuperscript{188} holdings must disclose such holdings and their intentions regarding such holdings if the investment is not passive. Under Section 16(a) of the Exchange Act, investors with over ten percent beneficial ownership are subject to more rigorous disclosure requirements.\textsuperscript{189} The effect of both of these rules is to deter block ownership of over five percent if confidentiality is preferred and to deter ownership over ten percent if expansive disclosure requirements are sufficiently onerous.\textsuperscript{190} In response, SWFs structure their transactions to specifically avoid triggering these thresholds.\textsuperscript{191} Other regulations further deter an SWF from

\begin{itemize}
  \item \textsuperscript{185} This was a solution proposed by Jennifer Cooke. Cooke, supra note 8.
  \item \textsuperscript{186} For example, Yvonne C.L Lee lists examples of other national security related regulatory regimes in different countries. Lee, supra note 144, at 1131.
  \item \textsuperscript{187} For example, SWFs are also subject to Section 20(a) of the Exchange Act and Section 15 of the Securities Act, which creates liability for “control persons” for misstatements or omissions in the controlled issuer’s SEC filings. Also SWFs are subject to Section 16(b) of the Exchange Act’s short swing profit rules. See 15 U.S.C. § 78u-2 (1934); 15 U.S.C. § 78p (1934).
  \item \textsuperscript{188} Rule 13d-3 specifies the definition for beneficial ownership. 17 C.F.R. § 240.13d-3 (2015). Such ownership includes direct or indirect voting power (which includes the power to direct the voting) and investment power (which includes the power to sell the security). The Williams Act, 15 U.S.C. § 78m(d) (2006); Exchange Act Rules, 17 C.F.R. § 240.13d-1 (2007). Also noteworthy is that the S.E.C. has international enforcement capabilities. See Testimony Concerning the Regulatory Framework for Sovereign Investments: Before the S. Comm. on Banking, Housing, and Urban Affairs, 110th Cong. (2008) (statement of Ethiopis Tafara, Director, Office of International Affairs, Securities and Exchange Commission), available at http://www.sec.gov/news/testimony/2008/ts0342408et.htm.
  \item \textsuperscript{190} As noted by Bainbridge, several regulations exist that “prevent shareholders from exercising significant influence over corporate decisionmaking.” Generally, these include disclosure requirements for large blockholders and shareholder voting rules. Although Bainbridge was referring to shareholder engagement generally, the same recommendations apply to empowering SWFs to become more active shareholders. Bainbridge, supra note 77.
\end{itemize}
becoming a “control person.” Some have advocated for even harsher disclosure requirements, such as creating a “rebuttable presumption” that all SWFs from the same country should have their holdings aggregated and “treated jointly,” thereby requiring earlier disclosures. Such proposals are inadvisable and would further deter investment. Instead, the securities regulations that remain should continue to serve the goal of transparency. Lastly, the United States should not institute ownership caps for SWFs.

In advocating transparency, securities regulations should consider several options. First, a comprehensive transparency regime should not solely target public companies, as a majority of SWF investments are privately negotiated purchases of ownership shares. Thus, the federal securities regime should coordinate with state regulations to push for transparency. The regulations should also aim to push for compliance with the Santiago Principles, perhaps by aligning requirements to create regulatory clarity. Regulators may also consider more creative approaches to encouraging transparency. For example, they may consider requiring an SWF to use an external asset manager or fully disclose its shareholder voting record when investing above the five percent level, or a similar threshold. Disclosure requirements could be modeled after the current rules under the Investment Company Act. Others, such as Rose, advocate for “continued vigilance, but not additional regulation.”

192. These include Rule 144 of the 1933 Act, Section 15 of the 33 Act, and Section 20 of the 1934 Act. Rose, supra note 29, at 16-17.
195. Bortolotti et al., supra note 4, at 17.
196. This was a proposal recommended by Amy Keller. This could also be a conditional approach—either use an external asset manager, or face disclosure of shareholder voting when investing above said threshold. Keller, supra note 24.
198. Rose, supra note 54.
Generally any regulations should be narrowly tailored. SWFs are already hesitant to invest after the financial crisis, and thus overly burdensome regulation should not serve as an additional disincentive. Moreover, data already indicates that SWFs primarily invest in their domestic economy. Investment-deterring regulations may hinder liquidity in the financial markets, which is a well-established contribution of SWFs. As such, reforms should pursue “regulatory proportionality,” instead of over-regulating. These criticisms and recommendations are tailored to the American legal regime, but apply equally to other countries in implementing global mandates.

VII. Conclusion

SWFs were understandably much discussed when they flocked to the American market in the midst of a credit crunch. The rhetoric during that period was largely focused on the fear of activism or the potential benefits. Now, in 2015, discussion of SWFs has waned. But that should be reversed. Today, analysts have empirical evidence that allows investors to assess whether SWFs are active or passive, and they can look at corresponding firm values to decipher whether that activeness or passiveness was good or bad for shareholders. Such evidence points toward a mixed answer: certain fears of irresponsible activeness may have merit, while the concerns of too much passivity also have merit. Disregarding these mixed results, empirical evidence has largely isolated a solution to both—transparency. Transparent SWFs engage in responsible active investing and subsequently bring value to corporate governance.

Thus, an international regulatory regime should be gradually established that fosters a tempered active investor environment by harnessing international law to emulate transparency. Although advocating for increased international law transparency for SWFs is not an entirely

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199. Cooke, supra note 8.
200. “For example, out of the USD 200 billion initial capital of China Investment Corporation... reportedly around 50% is reserved for international investments.” MehriPouya et al., supra note 66, at 12-13; see also Balding, supra note 86, at 15-16, 33-34.
201. Bortolotti et al., supra note 4, at 11.
novel idea, it has yet to be embraced as a method to improve the shareholder primacy model in corporate governance and to maximize firm value.

Once pundits and investors shift their discourse away from the swinging pendulum (fear of SWF politics and fear of SWF passive institutional apathy), regulators can discuss the real issue—how to create a value-enhancing middle ground.

203. “[T]here is broad agreement that SWFs should become more transparent and disclose their strategies and holdings.” BORTOLOTTI ET AL., supra note 4, at 10.