China's Sovereign Wealth Fund: Perceived Risks, Corporate Weaknesses, and Future Reform

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I. Introduction

Sovereign Wealth Funds (SWFs) are entities that manage state assets for investment purposes. Although the establishment of the world's first SWF, the Kuwait Investment Board, dates back to the 1950s,[1] SWFs have experienced an upsurge in the 21st century.[2] There are currently over forty known states globally that own SWFs, with some states having more than one SWF. It was reported that, by March 2017, total assets under management of SWFs worldwide recorded over $6.5 trillion.[3]

SWFs raise particular policy concerns in the host state (*i.e.* the country receiving the SWF investments). Some of the most controversial regulatory issues include the massive size of SWFs and their potential to destabilise the market of the host state as a consequence. Other additional causes for concern involve the blurred line

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1 The Kuwait Investment Board is the predecessor of the current Kuwait Investment Authority (KIA) established in 1982.

2 PwC, *Sovereign Investors 2020: A Growing Force (PwC Publications*, 2016*)* 7 <https://www.pwc.com/gx/en/sovereign-wealth-investment-funds/publications/assets/sovereign-investors-2020.pdf> accessed 25 August 2018.

3 Claire Milhench, 'Global Sovereign Fund Assets Stall at $6.59 Trillion – Preqin' *Reuters* (London, 13 April 2017) <https://www.reuters.com/article/global-swf-assets/global-sovereign-fund-assets-stall-at-6-59-trillion-preqin-idUSL8N1HL2GC> accessed 30 July 2018.

between private and public investments, a common lack of transparency in the structure and management of the SWF, the covert political agenda of the SWF's home state and strategic investment purposes that the SWF aims to pursue in addition to profit maximisation. Finally, one could refer to the potential detriment to the host state's national security and public interests in juxtaposition to the strategic or sensitive sectors.[4]

In addition to the above policy concerns that are perceived by host states in general, there are also implications raised particularly by the host state that are country-specific. China's outbound foreign investment is on the rise in recent years. China (including Hong Kong) remained the world's second largest FDI exporter in 2017.[5] Chinese outbound FDI always attracts elevated attention and vigilance from the host state, because of the combination of the massive size of the investments made and the peculiar nature of the Chinese state-led economy. What makes Chinese outbound FDI more high-profile, especially in recent years, is the promulgation of the Chinese government's systemic national campaigns that have a significant geopolitical and economic impact in the world, such as the One-Belt-One-Road Initiative[6] and the Made in China 2025 Plan.[7] These national campaigns are made at the central level of the government, aiming at, *inter alia*, the promotion of Chinese outbound investment for the purpose of strategic assets seeking motives and the upgrading of the domestic manufacturing value chain. These nation-wide and high-profile strategies have attracted much unease for several reasons, one

4 Simone Mezzacapo, 'The So-Called "Sovereign Wealth Funds": Regulatory Issues, Financial Stability, and Prudential Supervision' (European Commission Economic Papers 378, 2009) 26-27. For a comprehensive discussion of the regulatory concerns raised by SWFs, see Part III.B.

5 UNCTAD, *World Investment Report 2018: Investment and New Industrial Policies* (UN Publication 2018) 6.

6 The Belt and Road Initiative, also known as the Silk Road Economic Belt and the 21st-century Maritime Silk Road, and the One Belt One Road (abbreviated OBOR), is China's national development strategy proposed by Xi Jinping, which focuses on connectivity and cooperation among countries primarily between China and the rest of Eurasia, which consists of two main components, the land-based 'Silk Road Economic Belt' and oceangoing 'Maritime Silk Road'. The strategy underlines China's ambition to play a bigger role in global affairs, and its need for priority capacity cooperation in geo-political as well as economic areas. For a more comprehensive grasp of the Belt and Road Initiative, see, the State Council of the People's Republic of China, 'The Belt and Road Imitative' <http://english.gov.cn/beltAndRoad/> accessed 30 July 2018. See also the contribution of Yawen Zheng in this Special Issue.

7 The Made in China 2025 is a national strategy promulgated by the Chinese central government in 2015. The aim of the Made in China 2025 Plan is to boost China's domestic manufacturing to go up in the international value chain. The plan focusses on China's technological leadership in high-tech, strategic, and innovative industries, as it aims to increase the domestic content of core materials in manufacturing to 40% by 2020 and 70% by 2025. For a more detailed discussion, see, Scott Kennedy, 'Made in China 2025' (*Centre for Strategic and International Studies*, 1 June 2015) <https://www.csis.org/analysis/made-china-2025> accessed 30 July 2018.

of which relates to the heavy governmental dominance and planning to achieve the set objectives. This seems to direct China more towards a state-led economy instead of a market-led one. In such a context, Chinese firms investing overseas, both private and state-owned, may suffer from certain predetermined negative perceptions in the host state. This is because China's sovereign investors would manifest certain policy concerns raised by SWFs in general, as well as specific implications raised by Chinese outbound investments in particular.

To shed some light on the topic of China's SWFs in response to the diverse concerns raised, this paper embraces two main objectives. The first and foremost objective is the identification of the risks posed by FDI in general and by SWFs in specific in the host state. To clarify how these risks arise and why they are perceived in the host state, this paper aims to provide a narrative in which SWFs are considered 'high-risk'. The second objective is related to China's SWF, the China Investment Corporation (CIC). This paper aims at presenting some of the weaknesses and ambiguities in terms of CIC's corporate governance, and putting forward policy proposals for future reform.

To this end, this paper is arranged as follows. Part I provides a general introduction and analyses why China's SWFs are considered as particularly high risk and thus become the subject of discussion in this paper. Part II provides a mapping of SWFs, including their definitions, features, legal nature, and global magnitude. Part III aims at shedding some light on the identification of the risks posed by FDI in general and by SWFs in specific in the host state. In Part IV, the Santiago Principles promulgated by the International Working Group of Sovereign Wealth Funds in 2008 are discussed as a model of 'supranational self-regulation' of SWFs. In Part V, this paper conducts a case study, in which the trajectory and corporate weaknesses of the China Investment Corporation (CIC) identified in the literature are presented. Part VI puts forward normative proposals to alleviate such corporate governance concerns. This paper ends with a conclusion.

II. A Mapping of SWFs: Definitions, Features, Legal Nature, and Magnitude

The phenomenon of SWFs usually lacks a precise definition.[8] According to the concept endorsed by the Organization for Economic Co-operation and Development (OECD), SWFs are "pools of assets owned and managed directly or indirectly by governments to achieve national objectives."[9] This definition is

[8] PwC (n 2) 5.

[9] A Blundell-Wignall, Y Hu and J Yermo, 'Sovereign Wealth and Pension Fund Issues' (OECD Working Papers on Insurance and Private Pensions No. 14, OECD Publishing 2008) 4.

considered a rather broad one, as it may include all types of state-owned entities that function entirely or partially as investment vehicles.

Other attempts at defining SWFs prescribe certain limits to the notion, resulting in a more discerning conceptualisation. According to the standards of the International Monetary Fund (IMF), for instance, SWFs refer to:

> [S]pecial purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.[10]

Pursuant to the above characteristics endorsed by the IMF, SWFs are unique in their features compared with other government-related undertakings, such as state-owned enterprises. First of all, a SWF is owned by the central government and usually originates from either a commodity, *i.e.* representing the revenues of 'mineral wealth', or a non-commodity, *inter alia* fiscal surpluses and foreign exchange reserves. According to a statistical survey conducted by the Statistics Department of IMF, mineral royalties accounts for the majority (65%) of funds in the worlds' top twenty major SWFs.[11] Moreover, a SWF is an entity that makes its major investments overseas, which differs from state-owned funds that only make investments domestically. Finally, a SWF aims at profit maximisation for macroeconomic purposes, which includes boosting overall social welfare and the wellbeing of its citizens in the SWF's home country. To that end, SWFs usually employ investment strategies that are mid-term or long-term oriented.[12]

With regard to the legal nature of the SWF, its statutory basis and form may vary from country to country. According to a voluntary survey conducted by the initial twenty Members of the International Working Group of Sovereign Wealth Funds (predecessor of the International Forum of Sovereign Wealth Funds), 50% of the SWFs are established as legal entities with independent legal personality

[10] 'Sovereign Wealth Funds – Generally Accepted Principles and Practices' (hereinafter "the Santiago Principles") (*International Working Group of Sovereign Wealth Funds (IW G-SWF)*, October 2008) 27 <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf> accessed 30 July 2018.

[11] International Monetary Fund, 'The Statistical Work on Sovereign Wealth Funds' (*Twenty-First Meeting of the IMF Committee on Balance of Payments Statistics Washington, DC, BOPCOM-08/19*, 2008) 9 <https://www.imf.org/external/pubs/ft/bop/2008/08-19.pdf> accessed 30 July 2018.

[12] Dominic Barton and Mark Wiseman, 'Focusing Capital on the Long Term' (2014) 92 Harvard Business Review 44, 47.

under national company law. The other half are regarded as a pool of assets which do not have independent legal identity, operating under the control of the ministry of finance or the central bank of the home state.[13]

SWFs have been rapidly growing since the beginning of the 21st century, and will likely continue to do so.[14] There are currently over forty known states globally that own SWFs; some states have more than one SWF. By March 2017, it was reported that total assets under management of SWFs worldwide recorded over $ 6.5 trillion.[15] China ranks first in the list in terms of the assets its SWFs manage (see Table I below).

Table I

Top 10 countries that own SWFs (assets from high to low).[16]

Rank	Country	SWFs	Assets (Billion USD)	Origin
1	China (excl. Hong Kong)	CIC; SAFE; NCSSF; CADF	1,554	Non-Commodity
2	United Arab Emirates	ADIA; ADIC; EIA; ICD; MDC; RIA	1,298	Oil
3	Norway	GPF	1,063	Oil
4	Saudi Arabia	PIF; SAMA	697	Oil
5	Singapore	GIC; TH	556	Non-Commodity
6	Kuwait	KIA	524	Oil
7	Hong Kong	HKMA	456	Non-Commodity
8	Qatar	QIA	320	Oil
9	United States	APF; NMSIC; PWMTF; SIFTO; IEFIB; PSF; PUF; ATF; NDLF; LEQTF; CSF; WVFF	150	Oil; Non-commodity; Minerals; Public Lands
10	Australia	AFF; WAFF	134	Non-Commodity

[13] Cornelia Hammer, Peter Kunzel, and Iva Petrova, 'Sovereign Wealth Funds: Current Institutional and Operational Practices' (*IMF Working Paper WP/08/254*, 2008) 5.
[14] PwC (n 2) 7.
[15] Claire Milhench (n 3).
[16] Sovereign Wealth Funds Institute (SWFI), 'Sovereign Wealth F und Rankings' <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/> accessed 30 July 2018.

III. The Perceived Risks and Policy Concerns of SWFs

A. The security-related risks posed by foreign investment in general

The regulatory challenges posed by SWFs in the host state can be two-fold. The first layer, which is the focus of this subsection, involves security-related concerns that are raised in the general context of foreign direct investment (FDI), regardless of the private or state-controlled nature of the origin of the investment. The potential threats that foreign acquisitions of a domestic company could pose may be constituted in three categories.[17] The first type of threat concerns a foreign acquisition of a domestic company that would result in the dependence of the host state on a foreign-controlled supplier of goods and services that are critical for the survival and essential security of the host state, when there is credible evidence suggesting that the foreign controlled supplier would "delay, deny, or place conditions on" the availability and continuity of such goods and services.[18] This could pertain to the foreign acquisition of a domestic company controlling critical infrastructure, *inter alia*, seaports, electric power grids or petroleum production facilities, whereby the delay, denial or conditional restrictions of these goods or services would be disastrous to the host state once the foreign investor decides to abuse its power.

The failed CNOOC-Unocal merger makes an exemplary demonstration of the first type of threat. China National Offshore Oil Corporation (CNOOC), a Chinese state-owned-enterprise, announced its bid of $18.5 billion for Unocal, a US based oil and gas company, in 2005.[19] The merger announcement immediately faced vehement governmental opposition in the US. In the meanwhile, CNOOC voluntarily filed a request for a review by the Committee of Foreign Investment in the US (CFIUS), an inter-departmental agency responsible for the review and possible prohibition of foreign acquisitions based on national security considerations. CNOOC later announced that it withdrew its filing with CFIUS as well as the bid for Unocal.[20] Opponents of this transaction claim that, had the CNOOC deal been completed, CNOOC would likely hoard Unocal's oil reserve

[17] Theodore H Moran, *Three Threats: An Analytical Framework for the CFIUS Process* (Peterson Institute for International Economics 2009).
[18] ibid 1ff.
[19] Ben White, 'Chinese Drop Bid to Buy U.S. Oil Firm' *Washington Post* (New York, 3 August 2005) <http://www.washingtonpost.com/wp-dyn/content/article/2005/08/02/AR2005080200404.html??noredirect=on> accessed 2 September 2018.
[20] Souvik Saha, 'CFIUS Now Made in China: Duelling National Security Review Frameworks as A Countermeasure to Economic Espionage in the Age of Globalization' (2012) 33 Northwestern Journal of International Law and Business 199, 211.

and supply exclusively to China, which compromises US control over its own energy resources.[21] Furthermore, as a Chinese state-owned enterprise, CNOOC does not behave as normal commercial companies. Instead, it may infiltrate the US economy and inject a foreign power into it.[22]

The second type of threat concerns a proposed transaction that would result in the transfer of technology, or other intangible expertise of the target entity, to the foreign investor, which might be later abused in a manner that goes against the interests of the host state.[23] This type of threat was perceived by the US in the failed Thomson-LTV deal that dates back to 1992. Thomson CSF, a US subsidiary of a French government-owned company named Thomson S.A. that produced consumer electronics and semiconductors, proposed to acquire the US based LTV Corporation's missiles and aerospace divisions in 1992. Although bankrupted, LTV was still in possession of US government-funded technological advances and US military contracts.[24] Due to its sensitive nature, this merger quickly grabbed the attention, and later caused a public outcry. In April 1992, a CFIUS review of the deal took place. The whole review process was permeated with Congressional opposition and contentious political debate.[25] Eventually, Thomson withdrew its filing with CFIUS, and quit all attempts to acquire LTV.[26]

The third type of threat involves the insertion of a foreign investor in the host state, whereby such insertion is intended to achieve infiltration, surveillance, sabotage, espionage, and other illicit purposes of a disruptive nature.[27] Such a case might arise when a foreign investor purchases a domestic entity that is in the vicinity of an important military base in the host state. The botched Northwest-Firstgold merger case serves as an example. In 2009, Northwest, a Chinese SOE, proposed the acquisition to Firstgold, a US based gold mining company, of 51% of its stock.[28] Notably, the extraction site is adjacent to the US Navy's Fallon Naval Air Station, one of the Navy's top tactical training centres.[29] CFIUS reviewed the proposed deal, and later concluded that the national security perils

[21] Edward M Graham and David M Maechick, *US National Security and Foreign Direct Investment* (Institute for International Economics 2006) 130.
[22] Michael Petrusic, 'Oil and National Security: CNOOC's Failed Bid to Purchase Unocal' (2006) 84 North Carolina Law Review 1373, 1378–1379.
[23] Theodore H. Moran (n 17) 1ff.
[24] Jeremy David Sacks, 'Monopsony and the Archers: Rethinking Foreign Acquisitions after Thompson-LTV' (1994) 25 Law & Policy in International Business 1019, 1020.
[25] ibid 1031.
[26] ibid 1031.
[27] Theodore H. Moran (n 17) 1ff.
[28] Jingli Jiang and Gen Li, 'CFIUS: For National Security Investigation or for Political Scrutiny?' (2013) 9 Texas Journal of Oil, Gas and Energy Law 67, 88.
[29] ibid 88.

posed in this deal were "serious, significant and consequential", and impossible to be mitigated.[30] As a result, both parties withdrew the notification and aborted the transaction before CFIUS officially rejected the deal. This failed acquisition is unique in CFIUS history, due to the fact that it is the very first rejected acquisition in the US, not because of the sensitive nature of the deal itself, but the geographic vicinity to a US military facility.[31]

B. The particular risks and concerns raised by SWFs

In addition to the generally recognised national security-related concerns FDI may bring to the host state, SWFs pose additional concerns other than private investors and state-owned-enterprises acting as private market participants.

The first concern results from the magnitude of the SWFs. The world's top ten largest SWFs control aggregated assets of over $ 5727 billion as of June 2018 (see Table II below), which surpasses the total GDP of dozens of sovereign countries.[32] The formidable financial power of SWFs leads to a potentially systemic problem, whereby SWF investments may "contribute to the creation of asset bubbles" or "collectively withdraw their investments thus causing market crashes."[33] This is particularly the case if SWFs aim at short-term investments where the sale of assets is frequent.

[30] ibid 89.
[31] Margaret L Merrill, 'Overcoming CFIUS Jitters: A Practical Guide for Understanding the Committee on Foreign Investment in the United States' (2011) 30 Quinnipiac Law Review 1, 17.
[32] According to the International Monetary Fund, in 2017, Fiji had a recorded GDP of 5054 billion USD, ranking No. 150 out of 191 countries of the world in terms of the value of GDP. This means that 42 countries in the world have a lower number of GDP than the aggregated assets of world's top 10 SWFs combined. See, IMF, 'World Economic Outlook Database, Gross Domestic Product 2017' <http://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx> accessed 25 July 2018.
[33] Georges Kratsas and Jon Truby, 'Regulating Sovereign Wealth Funds to Avoid Investment Protectionism' (2015) 1 Journal of Financial Regulation 95, 107.

TABLE II

Largest SWFs by assets under management worldwide [34]

Rank	Country	Name of the SWF	Asset (Billion USD) as of June 2018	Origin of Capital
1	Norway	Government Pension Fund Global	1035	Oil
2	China	China Investment Corporation	941	Non-commodity
3	UAE	Abu Dhabi Investment Authority	683	Oil
4	Kuwait	Kuwait Investment Authority	592	Oil
5	Saudi Arabia	SAMA Foreign Holdings	494	Oil
6	Hong Kong	Hong Kong Monetary Authority Investment Portfolio	456	Non-commodity
7	China	SAFE Investment Company	441	Non-commodity
8	Singapore	Government of Singapore Investment Corporation	390	Non-commodity
9	Singapore	Temasek Holdings	375	Non-commodity
10	Qatar	Qatar Investment Authority	320	Oil & Gas

The second concern relating to SWFs is their lack of transparency. Currently, there are no regulations regarding the disclosure of information by SWFs concerning matters such as their size, investment strategy, institutional structure, management and governance, or current holdings. SWFs are not legally obliged to

[34] SWFI (n 16).

disclose information to any stock-holders or state-holders.[35] Minimal transparency also results in low accountability, which in turn creates more policy concerns such as obscure governance, risk-management problems, asymmetries of information between SWFs and regulators of the host state, and corruption.[36] Some have associated the opacity of SWFs with information asymmetries as one of the market imperfections and failures that inherently occur.[37]

The third concern of SWFs resides at the corporate level, regarding their non-commercial investment motives and use of political leverage. Government control of the SWF could result in investment decisions not always being in the best interest of commercial value creation. Instead, government-controlled assets may be used to seek strategically important stakes in businesses in host states around the globe such as critical infrastructure, telecommunication, emerging high-technology, energy resources, and financial institutions.[38] There is a general suspicion that SWFs might abuse their voting power in the acquired entity once they gain control.

IV. The Santiago Principles as a Model of 'Supranational Self-Regulation' of SWFs

In October 2008, the International Working Group of Sovereign Wealth Funds, which is an organisation under the administration of International Monetary Fund (IMF), endorsed the Sovereign Wealth Funds, Generally Accepted Principles and Practices (hereinafter "Santiago Principles") in Santiago, Chile. The Santiago Principles are a set of twenty-four 'best practices' that promote transparency, accountability, effective operations and good corporate governance of SWFs, which currently only act as non-binding code, or 'international soft law'.[39] Specifically, the Santiago Principles promote three key components to achieve better governance of SWFs, namely, their legal framework, institutional framework, and investment and management framework.[40] These components underpin an independent position and governance structure that separates the functions of the governing body and the management of the SWF, so as to avoid

[35] Martin A Weiss, 'Sovereign Wealth Funds: Background and Policy Issues for Congress' (*US Congressional Research Service RL34336*, 15 January 2009) 9–10.
[36] ibid.
[37] Georges Kratsas and Jon Truby (n 33) 108–109.
[38] Yvonne C L Lee, 'The Governance of Contemporary Sovereign Wealth Funds' (2010) 6 Hastings Business Law Journal 197.
[39] Locknie Hsu, 'Multi-Sourced Norms Affecting Sovereign Wealth Funds: A Comparative View of National Laws, Cross-border Treaties and Non-binding "Codes"' (2009) 10 Journal of World Investment & Trade 793.
[40] The Santiago Principles (n 10) 5.

excessive political influence.[41] At the same time, the Santiago Principles promote transparency in all levels of governance, a clear investment policy that demonstrates "an SWF's commitment to a disciplined investment plan and practices", and a reliable risk management framework that adheres to the soundness of operations and accountability.[42]

The Santiago Principles do not create any international law obligations for states to comply with. Instead, what the Santiago Principles advocate is an alternative model that differs from state regulatory intervention through public law of the host state. It is a model of "supranational self-regulation" that is buttressed by a set of generally accepted principles and values which aim to achieve "the effectiveness and legitimacy of a governance structure".[43]

The Santiago Principles are regarded as "an inventory of best practices that already exist", a set of rules that in practice have already been adopted by at least one or a few SWFs.[44] The deference to the Santiago Principles is conducive to better compliance with the regulatory framework of the host state. An effective program of self-regulation by SWFs would significantly assure the regulators of the host state that the perceived risks posed are either non-existent or exaggerated. Hence downright rejecting SWF investments would be irrational, considering the economic benefits those benign SWF investors may bring about to the host state.

V. The Trajectory and Corporate Weaknesses of the China Investment Corporation (CIC)

A. The trajectory of CIC

The inception of CIC in 2007 has re-invoked the already heated debate regarding SWFs in global society. CIC was founded as a wholly state-owned-enterprise incorporated under China's company law. CIC was registered with a capital of $200 billion out of China's then $1.4 trillion in foreign exchange reserves. As of June 2017, CIC has become world's second largest single SWF, managing assets of over $900 billion in total.[45] CIC is purported to act as "a vehicle to diversify China's foreign exchange holdings and seek maximum returns for its

[41] ibid.
[42] ibid.
[43] Georges Kratsas and Jon Truby (n 33) 127.
[44] Katinka Barysch, Simon Tilford and Philip Whyte, 'State, Money and Rules: An EU Policy for Sovereign Investments' (Centre for European Reform Essays, 1 December 2008) 14 <https://www.cer.eu/publications/archive/essay/2008/state-money-and-rules-eu-policy-sovereign-investments> accessed 30 July 2018.
[45] See Table II.

shareholder within acceptable risk tolerance".[46] CIC has successively established three subsidiaries, namely CIC International Corporation Limited (hereinafter "CIC International 2011"), CIC Capital Corporation (hereinafter "CIC Capital 2015"), and Central Huijin Investment Limited (hereinafter "Central Huijin 2003"). CIC International 2011 and CIC Capital 2015 undertaking investment overseas while Central Huijin 2003 only making equity investments in domestic state-owned financial institutions. According to the CIC official website, both CIC International 2011 and CIC Capital 2015 are market-oriented commercial investors with individual mandates, conducting investments in public market equities and bonds, hedge funds, real estate, private equity and other long-term assets.[47]

CIC is a founding member of the International Working Group of Sovereign Wealth Funds back in 2008 and participated in the preparation as well as publication of the Santiago Principles. CIC has made it quite clear that it appreciates the need for compliance with international best practice and is willing to cooperate with the International Forum of Sovereign Wealth Funds (the successor of the International Working Group of Sovereign Wealth Funds since 2009), by making several laudable gestures. For instance, CIC published its first annual report right after being founded in 2008.[48] Commentators commend CIC's consistent endeavour to build a fairly transparent and public image, and so far, there is no substantial evidence suggesting that CIC has been abused by the Chinese government to achieve any clandestine political agenda, nor is it wielded as a "political weapon" to pursue any geopolitical goals.[49]

With regards to past investment patterns of the CIC, in an empirical study conducted on all CIC investment transactions made from 2007 to 2013, it was found that "CIC usually holds significant but non-controlling equity stakes". Further, "CIC's voting rights, to the extent the relevant information is available,

[46] China Investment Corporation, 'Abut CIC, Overview' <http://www.china-inv.cn/wps/portal/!ut/p/a1/jZFBc4IwEIX_Si8caZYQCR7TQBFbWqs4CpdMsEGZwcCI48FfX-8AzqXvazXxv32YeytEe5VreqqO8Vo2W9TDnnvgCDxy-gSUk7B2YD2Hy7S7jj9Drg-WwSwBHBz-l5xBaEfgIA8THEwdsioPMEIPae08NEMfhPn_V6OgVwcNEG5Sjf8US-sYpQ5w8DT3tSCw6nS0q707aVtLldZW3BqzkoobUESBjEbu9VFdZ1Yq1rJTnX907BAd-8LoKUY7eVSvLj3QosClPXMLxyaUYLsgVNmu_-vP6Nx3So-iDKPdsNbwUU7NQJSagUe-SI2CKagRMWRiP7C3a83a7v6equJdtuA5__gDaBDC3/dl5/d5/L2dBISEvZ0FBIS9nQSEh/> accessed 30 July 2018.
[47] ibid.
[48] China Investment Corporation, '2008 Annual Report' <http://www.china-inv.cn/wps/wcm/connect/7c8d7b47-d278-4900-b3b5-4e50061d4e2a/CIC_2008_annualreport_en.pdf?MOD=AJPERES&CACHEID=7c8d7b47-d278-4900-b3b5-4e50061d4e2a> accessed 27 August 2018.
[49] Jean-Marc F. Blanchard, 'The China Investment Corporation: Power, Wealth or Something Else?' (2014) 12 China: an International Journal 155, 172.

are often restricted in the investment contracts it entered into with their targets", and that "there is no evidence of CIC pursuing shareholder activism by exercising its voting rights or bringing up proposals, neither in shareholder or board meetings of its portfolio companies".[50] The empirical study concludes that, based on its track records, CIC did not actively seek control over target firms and was largely a passive investor, with only a few exceptions, where CIC did make a representation in the board of directors in the target company.[51]

B. Corporate weaknesses of CIC

The concerns regarding CIC can be divided into three categories. The first concern relates to the debatable character of CIC as either a financial investor or a strategic one. The second concern is the questionable commitment made by CIC to passive investments; the third involves the internal weakness of CIC.

First of all, CIC has been questioned as to its investment strategies. Questions are raised whether investments are made on purely commercial merits, or for strategic and political reasons as part of the Communist Party of China (CPC)'s larger policy.[52] Since 2009, CIC has made direct investments in companies of strategic importance in the host state, including IT, telecommunications, energy and natural resources.[53] This shift in investment strategy has invoked some speculation that these developments might reflect the Chinese government's overall strategy to gain better access to energy and natural resources, to support China's rapid domestic economic growth, among other macroeconomic considerations[54] Another speculation is that Central Huijin 2003, one subsidiary of CIC which only makes investment in major Chinese state-owned banks, has been indirectly financing large Chinese state-owned-enterprises and private companies for their overseas acquisitions, as those Chinese state-owned-enterprises and private companies

[50] Jing Li, 'State as an Entrepreneur: A Study of the Investment Contractual Terms and Level of Control of China's Sovereign Wealth Fund in Its Portfolio Firms' (2015) 3 Peking University Transnational Law Review 1, 9.
[51] ibid 98.
[52] Michael F Martin, 'China's Sovereign Wealth Fund: Developments and Policy Implications' (US Congressional Research Service, Report for Congress, R41441, 23 September 2010) 9-10.
[53] See below Table III.
[54] Michael F. Martin (n 52) 9–10.

investing overseas seek financial support from major Chinese state-owned banks.[55] As a result, CIC might also be involved in strategic investments overseas indirectly.

Table III

CIC global investment portfolio distribution by sector as of December 2017[56]

Ranking	Sector	Percentage
1	Financials	20.1%
2	Information Technology	19.4%
3	Consumer Discretionary	11.7%
4	Healthcare	10.6%
5	Industrials	10.5%
6	Consumer Staples	7.9%
7	Energy	5.4%
8	Materials	4.4%
9	Utilities	2.7%
10	Real estate	2.5%
11	Telecommunication services	2.4%
12	Others	2.4%

The second concern is CIC's inconclusive character as either an active investor or a passive one. There are, in principle, two kinds of institutional investors, namely financial investors and strategic investors.[57] Financial investors are those who make investment solely for the purpose of financial return maximisation, with little or no intention in gaining control over the target company, whereas strategic investors seek control over the target company so that they can play a more influential role in the management of the investee. Hence, the decisive factor that distinguishes a financial investor from a strategic one is whether control over the target company is sought. Because of the strong governmental backgrounds SWFs inherit, most SWFs choose to act as a sheer financial investor so as to assure the host state that there will be no control sought over the target company. Thus, investments made by

[55] ibid.
[56] China Investment Corporation, '2017 Annual Report' <http://www.china-inv.cn/wps/wcm/connect/e6947335-0efd-492b-bd2f-09a3a9187f69/CICAnnualReport2017.pdf?MOD=AJPERES&CACHEID=e6947335-0efd-492b-bd2f-09a3a9187f69> accessed 31 August 2018.
[57] Ming Zhang and Fan He, 'China's Sovereign Wealth Fund: Weakness and Challenges' (2009) 17 China & World Econonmy 101, 108.

SWFs would face less opposition in the host state. With regard to CIC's position, its investment strategy is to a large extent mixed, although CIC depicts itself as a pure financial investor. CIC has retained the option, in some of its recent investments, to appoint representatives to the board of directors, so that it may have the choice to exert substantial influence.[58] Due to a lack of disclosure from CIC itself, there is no evidence suggesting that CIC has never sought control in its investment portfolio.

The last concern regarding CIC is its weak internal governance. The CIC management team is composed of government officials, who may be appointed not because of their outstanding professional expertise and experience, but because of their political position. The current board of directors of CIC is composed of nine directors, all of whom are either former government officials or are still in service. The Vice President of CIC, Tu Guangshao, for instance, was the Vice Mayor of Shanghai immediately prior to his appointment as the Vice President in CIC.[59] The possible bureaucratic management of CIC and the management's close linkage to the government make it less credible that CIC operates under a completely independent corporate management. This invites further suspicion that CIC might be subject to political interventions when making investment decisions. Some have contended that "if SWFs are run by politically connected but financially inexperienced managers, we might expect that not only would they make poor choices in their home and foreign investments, but they would also display poorer stock-picking ability even looking solely at the international portfolio of the fund".[60] If CIC is managed by generalist politicians instead of specialist professionals, there is a concern that politicians may exploit their position

[58] Michael F Martin (n 52). See also, Fridrich Wu and Arifin Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?' (2008) 16 China & World Economy 33.

[59] China Investment Corporation, 'Governance, Board of Directors' <http://www.china-inv.cn/wps/portal/!ut/p/a1/jZTBcoIwEIZfpRePNEsSEjwioqJirdoqXBiwUZlRdMTx4NOX0E57Y-mO4EOb78i-wCUnIhiRldi_22a04l9lRzxORzkCA7S9hDJE3AM-FIHpj43AyZTUQtwJ0y-CnqO_Dr-0NvxOUUALhLIez3Rn3ZjQBC8ZwPLcMDxKdez1C_BjB_4Rj8GsD8mTD-4M4H6A2rwBxT1P7nBrwHEfwfAfQ1g-WODrwHs_7v492-Ap_oHAQz9H9e-bAN8YGR-JEpKs_SidhyS29cRf1aEd2B6KMrOK8v5yOV9v2bEDh_NJparsQBT0Q6-5m19VVaULd-VRZpar6kV6grFI0M23isr16ZXIr85zuLIfltsUlp1bOpbKY--U6suvaOyFJTMlaL4u8qC9xYL-jCgZ-ToAGwrd4A2F5Gi_yLaOumJTMAwjYAkTAAATUUOeHkcvr4H5vHSuWP3SVYNN-c3On_ysA!!/dl5/d5/L2dBISEvZ0FBIS9nQSEh/> accessed 30 July 2018.

[60] Shai Bernstein, Josh Lerner and Antoinette Schoar, 'The Investment Strategies of Sovereign Wealth Funds' (2013) 27 Journal of Economic Perspectives 219, 223.

in CIC for the purpose of pursuing their personal political agenda instead of profit maximisation.

VI. Proposals for Reforming the CIC

A. Increased transparency

The first step of reform is the promotion of better transparency and information disclosure. As laid down in the Santiago Principles, "the key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed (GAPP 1.2)", "there should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations (GAPP 4)", and 'the relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets (GAPP 5).'[61]

It is worth mentioning that, according to the 'Linaburg-Maduell transparency ranking' of SWFs, CIC's has already improved from the one of the lowest scores of two (out of ten) to a significantly higher score of eight.[62] This means CIC is already considered more transparent than the average SWF. Yet, CIC has not publicly disclosed its holdings on its official outlet. To promote better transparency, this paper proposes that CIC should act in accordance with the desirable level of transparency the Norway Government Pension Fund Global has adhered to. The Norway Government Pension Fund Global lists all investments and their returns regardless of the size of the holding in the target companies on its official information outlet in the public domain, along with its debt and equity mix, as well as identifications of its managers.[63]

B. Diversified investment strategy

The foregoing leads to a second proposal to reform CIC, which involves a voluntary commitment to purchase only small stakes in diversified target companies. This proposal originates once again from the practices of the Norway Government Pension Fund Global, which in principle holds less than 1% of the shares of every

[61] The Santiago Principles (n 10) 7.

[62] Sovereign Wealth Fund Institute, 'Linaburg-Maduell Transparency Index' <http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/> accessed 30 July 2018.

[63] Norges Bank, 'Government Pension Fund Global, Annual Report 2017, Part 3 Investments' <https://www.nbim.no/contentassets/49715a01ed684b1686ff3c017f1efa12/annual-report-2017--government-pension-fund-global.pdf> accessed 27 August 2018.

investee company in over three-thousand companies worldwide. SWFs have the potential to destroy target firms or even destabilise an entire industry in the host state, when a massive amount of capital made by a single investment of a SWF enters the market, and the SWF subsequently decides to unwind the investment because of unsatisfactory returns. A diversified investment strategy of the SWF will effectively alleviate the policy concerns of the host states. When there is an ownership ceiling in the SWFs investment strategy in place, it "mitigates fears that large capital flows from SWFs will be used to destabilise markets or governments".[64] Hence, the most viable solution available to guarantee market stability against the potent power of SWFs is to self-limit the equity stake in the target company.

C. Passivism in voting rights in the investee

The third reform option is the voluntary commitment to purchase non-voting shares in the target company, or the commitment of refraining from exerting voting rights. Non-voting stock is a type of stock which provides all other legitimate rights a shareholder is entitled to, except that it does not grant the right to vote on various (important) matters, such as the election of the board of directors or mergers. When CIC seeks to purchase only non-voting stocks of a target company, or otherwise, voluntarily forfeits its voting rights and seat(s) in the board of directors in the target company, it ensures the target company that it will not pursue any management role. As a matter of fact, CIC has already implemented the refrainment of its voting rights in practice in a couple of transactions. For instance, in 2007, CIC acquired 9.9% of total outstanding shares in Morgan Stanley while agreeing to have no managerial role in the company as a sole passive investor.[65] This paper hence advises that CIC consider adopting a self-restraint clause in its Articles of Association, stating that either it will only invest in non-voting equity shares of the target company, or it will not exert any voting-rights, even if it becomes a substantial shareholder, so as to solidify its stance as a sheer financial investor.

VII. Conclusion

Unlike private investors, SWFs are ultimately owned by sovereign governments, which has regulatory implications that cannot be easily reconciled with the host state. The rapid growth of SWFs from emerging market countries, in combination

[64] Jason Buhi, 'Negocio De China: Building Upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation' (2009) 39 Hong Kong Law Journal 197, 214.

[65] Christian Plumb, 'China Investment Corp Buys $5 Billion in M. Stanley Units' *Reuters* (New York, 19 December 2007) <https://www.reuters.com/article/morganstanley-china/china-investment-corp-buys-5-bln-in-m-stanley-units-idUSN1957628320071219> accessed 30 July 2018.

with their financial significance, lack of transparency and potential political and strategic motivations have worried policy makers regarding how these SWFs have been investing.[66]

Chinese investors in general are believed to pose additional concerns, because of China's particular socialist-political economy. Following the Western countries' long-held doubt on China's one partisanship and its questionable position as a market economy, there is a general perception that governmental intervention in the market can be excessive and ubiquitous in China.[67] Chinese outbound investments are hence regarded as exuding 'high-risks' because of the suspicion of containing a hidden political agenda or even espionage in the host state. Under such circumstances, it is no surprise that Chinese SWFs would pose more of a concern in the host state than SWFs of a country that is considered an 'ally' of the host state.

It is then not entirely surprising to see that Chinese sovereign investment vehicles such as CIC would raise some particular policy concerns in the holistic FDI policy context of the host state. As the President of CIC stated in a press interview in January 2018, "countries have 'specifically' targeted China as it makes more foreign investments", and CIC is increasingly facing obstacles and resistance in its investments overseas due to protectionism on the rise.[68] Security-related risks are perceived when the host government believes that CIC wishes to gain control in target firms in strategically important sectors in the host state, and possibly abuse such control for non-economic purposes. Often, however, alleged ulterior motives have not been observed in practice. Although apparently, a good track record is in place, it is the particular character of CIC that alerts the regulators of the host state. The abundant financial power of CIC and its association with the Chinese government, both in terms of ownership and management, make it typically susceptible to heightened governmental scrutiny. To effectively address the security-related concerns, this paper concludes that CIC should emphasise the importance of self-regulation promoted by the Santiago Principles. This may include a combination of measures that warrant the non-controlling nature of the investments of CIC, so as to assure the host state that CIC is a sheer financial investor with only passive investment motives, but not a strategic, activist investor.

[66] Martin A. Weiss (n 35) 7.

[67] Gisela Grieger, 'Foreign Direct Investment Screening – A Debate in Light of China-EU FDI Flows' (European Parliamentary Research Service Briefing, May 2017) 4.

[68] Cheang Ming and Bernie Lo, 'Countries are "Specifically Targeting" China with "Protectionism", Official Says' (*CNBC Finance*, 16 January 2018) <https://www.cnbc.com/2018/01/15/china-wealth-fund-faces-protectionism-says-cic-president.html> accessed 2 September 2018.