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WLF Paper Examines Legal & Policy Issues Relating to "Sovereign Wealth Funds"

American unease with foreign investment in U.S. companies and properties has long been a cyclical phenomenon. The latest targets of this discomfort are so-called sovereign wealth funds, state-run investment entities from nations as diverse as China, Abu Dhabi, and Norway. As the authors of a new Washington Legal Foundation WORKING PAPER note, public and U.S. policy maker anxiety is heightened by concerns over the possible political, rather than financial, motivations of wealth fund investments, and the impact they may have on American national and economic security. But as the authors argue, the current U.S. regulatory framework may be ill-suited to address these valid concerns.

This publication, **SOVEREIGN WEALTH FUNDS: THE EVOLVING LEGAL AND REGULATORY LANDSCAPE**, was authored for WLF by **John L. Walker**, a partner with the law firm Simpson Thacher & Bartlett LLP, and **Mark J. Chorazak**, an associate with the firm.

Sovereign wealth funds are not a new player on the international investment scene, but their increasing focus on America's struggling financial services sector has forced many in the U.S. to learn more about them. Walker and Chorazak recognize this knowledge gap in the WORKING PAPER's first section, which looks at the underlying economic conditions of wealth funds' sovereign backers. They identify two types of funds – those which are based on revenues from commodities such as oil, and ones that benefit from foreign exchange account surpluses.

The authors next discuss some of the sovereign wealth funds' most sizable and prominent investments in the past year, and the American public's and policy makers' reaction to them. Despite the paucity of evidence to support their allegations, some policy makers have accused some funds of having political motivations. From a policy making perspective, the major concern that currently exists with sovereign wealth funds, Walker and Chorazak argue, is transparency, or the lack of it, of the funds and their decision making process.

Sovereign wealth funds' transparency varies, the paper notes, and that disparity has led to attempts by such international bodies as the International Monetary Fund and the Organization for Economic Co-Operation and Development to create uniform transparency guidelines. The call for transparency, the authors argue, "although an important one, is likely just the beginning of a larger, more complicated dialogue on how investments by sovereign wealth funds will be reviewed by recipient countries." This notion leads the authors into a detailed discussion of how American regulators oversee foreign investment, especially in the financial sector. The paper comprehensively details the two regulatory fronts wealth fund investments must face – the Federal Reserve and the Committee on Foreign Investment in the U.S. (CFIUS). Tensions between the two regulatory bodies, and their processes, arise in three areas detailed by the paper: 1) whether a sovereign wealth fund is a "company"; 2) whether a transaction would result in the "control" of a U.S. entity; and 3) if a targeted financial services entity is considered "critical infrastructure" of the U.S., which entity, CFIUS or the Federal Reserve, should examine national security concerns.

The authors conclude the WORKING PAPER with a cautionary note, one which they feel is critical in crafting the correct legal and regulatory framework for addressing sovereign wealth funds: "Meaningful study and treatment of sovereign wealth funds can come only if policymakers recognize that these funds may not be problematic to American competitiveness and security but rather are symptomatic of larger, fundamental changes in the global economy."

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Printed copies of this educational paper, WLF WORKING PAPER, Number 159 (August 2008), can be obtained by forwarding a request to: Publications Department, Washington Legal Foundation, 2009 Massachusetts Avenue, NW, Washington, D.C. 20036, or calling (202) 588-0302.

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