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Improving Cross-Border Investment Regulation: A Case Study of China’s Largest and Least Known Sovereign Wealth Fund

Margalit Faden*

This paper highlights current problems in the international regulatory regime governing sovereign wealth funds by examining Chinese-funded Safe Investment Company’s equity investments into three Australian banks. It proceeds by analyzing how the operative laws and international agreements governing those investments—Hong Kong law, Australian law, the New York Convention, and customary international law—fail in part to adequately regulate the cross-border investments of one of the largest and most opaque sovereign wealth funds in the world. Assessment of existing legal oversight and Hong Kong’s strict absolute sovereign immunity stance leads to the conclusion that the Safe Investment Company’s investments must be closely regulated. As sovereign wealth increasingly makes its way across borders, domestic or regional legislation accounting for the unique considerations attached to sovereign wealth investments must be carefully crafted by both developing and developed countries. As such,

* LL.M., Asian Legal Studies, National University of Singapore; J.D., Boston University School of Law. Special thanks to Professor Yvonne C. Lee for providing useful feedback and encouraging words during work on this article. Also, thank you to Professor Diana R. H. Winters for involving me in her writing process. Lastly, I am grateful to my family for their constant support. All mistakes are always my own.
communication channels between “like economies” need to be established to consider how best to regulate such investments. Additionally, discussions must be held between those countries that have already developed foreign investment policies sensitive to opaque investment of sovereign wealth and those that have not.

I. INTRODUCTION

Since they stepped onto the financial scene, sovereign wealth funds (SWFs) have caused a stir. Their distinctive stature as funds originating from sovereign power involves consideration of additional issues not usually linked to conventional institutional investors. This article explores the mechanisms by which an SWF’s actions are regulated by examining a case study in Section II of a typical portfolio investment by an opaque SWF, Safe Investment Company Ltd., into three Australian banks. Section III analyzes why and how such mechanisms can be improved to facilitate better oversight of SWFs like Safe Investment Company. Section IV concludes that adequate regulatory oversight of Safe Investment Company can be provided by relying upon international investment treaties and host countries’ foreign investment policies. The unique considerations

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II. CASE STUDY

A. Description of Safe Investment Company

1. Origin and Structure

The State Administration of Foreign Exchange (SAFE) was established in 1978. SAFE is primarily charged with managing the People’s Bank of China’s (PBoC) foreign exchange activities and overseeing foreign exchange market activities. SAFE is led by four deputy administrators and one administrator. Ties with other government entities exist. SAFE’s administrator acts as the Deputy Governor of the People’s Bank of China and sits, along with one SAFE deputy administrator, on the board of the China Investment Corporation as a non-executive director. This overlap between the two entities may prevent them from stepping on each other’s toes when assessing investments but additionally opens up the possibility of information sharing that could potentially affect markets.

The Safe Investment Company Ltd. (SIC) was registered in Hong Kong on June 2, 1997. It is one of four overseas SAFE subsidiaries. The other three are in Singapore, London, and New York. SIC is constituted of 300 million ordinary shares, each with a nominal value of HKD 1. Both its authorized and issued share capital is HKD 300 million (about 38.56 million USD). All shares

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are owned by SAFE. Additionally, SIC’s 2011 annual return lists three directors and one secretary. The secretary resides in Hong Kong and is responsible for ensuring compliance with Hong Kong law and for maintaining the company’s records and books. One director is listed as residing in Hong Kong, and two are listed as residing in the PRC. One PRC director, Yin Yong, is also the Director General of SAFE, which is the highest executive office in the organization.

2. Sources of Funding

Although no information is publicly available concerning funding sources, it appears that SIC’s funding comes primarily from SAFE’s earnings on foreign exchange transactions. SAFE has released data stating that its investments abroad, both portfolio and direct, currently total about 589.5 billion USD. The percentage of those investments that SIC handles, however, is unclear. Furthermore, SIC’s Memorandum of Association states that one of its objects is “to undertake the management of state foreign exchange reserves or other business authorised by central banks.” It states that another purpose underlying its creation is “to undertake the management of investment funds of all types on a worldwide basis.”


7 2011 Filed SAFE Investment Company Ltd. Annual Return, supra note 6, at 3.

8 2011 Filed SAFE Investment Company Ltd. Annual Return, supra note 6, at 4-10.


12 Further elaborating, the Memorandum of the Articles of Association states that SIC is established:

To act as an agent of the “People’s Bank of China Head Office/State Administration of Foreign Exchange Head Office” in carrying out the business of managing state foreign exchange reserve funds and all other related monetary and financial business activities as instructed and authorized by the “People’s Bank of China Head Office/State Administration of Foreign Exchange Head Office.”
For the first ten years of its existence, SIC was dealing with only a small amount of money. How it came to be more active seems to be related to a rivalry within the government between the Ministry of Finance and the PBoC. When the creation of an SWF was first proposed, the PBoC rejected the idea. As it became clear that an SWF indeed would come to be, the Bank argued that it would be in a better position to manage the SWF than the Ministry of Finance. Instead, the newly-created SWF—the China Investment Corporation (CIC)—was put under the control of the State Council. Its staff, however, was largely tied to the Ministry of Finance.13

The PBoC became further aggrieved by the method chosen to finance the CIC. In 2003, Central Huijin Investment Ltd. was set up under the purview of the PBoC to operate as the government’s investor in large state-owned financial enterprises. In 2007, the Ministry of Finance issued special treasury bonds. The bonds were used by the Ministry of Finance to purchase 100% of Central Huijin from the PBoC at below-market prices14 as an initial capital contribution for the CIC.15 Hence, control over investment into domestic state-owned banks was wrested from the PBoC in order to set up the CIC. In response to the deprivation of one of its central functions as manager of investments into state-owned banks and with the argument that it could have sufficiently operated an SWF, SAFE started to use SIC more actively to manage excess portions of its reserves.16

3. Is SIC a Sovereign Wealth Fund?

SIC is not a member of the International Working Group of Sovereign Wealth Funds, which is responsible for drafting the “Santiago Principles.” These soft law guidelines are intended to stand as principles of general “best practices” for SWFs. The full report created by the Working Group, which also includes the background and intent behind the “Santiago Principles,” provides a definition of SWFs. The Working Group identified three essential elements, which are that (1) the general government owns the SWF, (2) the SWF invests in foreign financial assets, and (3) the SWF is created by the government to fulfil specific financial

13 U.S.-CHINA ECON. AND SEC. REVIEW COM’N, 2008 REPORT TO CONGRESS (Nov., 2008) at 52.
14 Id.
objectives. Additionally, the Working Group suggests examples of entities that should not be categorized as SWFs:

This definition excludes, inter alia, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, operations of state-owned enterprises in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals. Although it appears that funds held for balance of payments purposes, like SAFE’s reserves, might be excluded, the Working Group explains in Appendix I to its explanation of the “Santiago Principles” that the intention is to exclude foreign exchange reserves managed solely for traditional purposes but that excess portions managed like sovereign wealth may still be categorized as an SWF for definitional purposes. Indeed, the Appendix states that “[w]hile SWFs may include reserve assets, the intention is not to regard all reserve assets as SWFs.”

Although no primary information exists about SIC, from the information that has been gathered in this article, it appears that the SIC falls within the Working Group’s definition. As such, the article adopts the Working Group’s definition and categorizes SIC as an SWF.

4. Investment

SAFE shares information concerning its international investment position on its website. According to its July 2011 report, it is currently holding 329.1 billion USD in direct investments abroad and 260.4 billion USD in portfolio investments, totalling 589.5 billion USD. Of those portfolio investments, 62.2 billion USD are in equities and 198.2 billion USD are in debt securities. Nonetheless, the proportion of these investments that SIC manages on behalf of SAFE remains unclear, as it appears that other asset management institutions are also involved in handling SAFE’s reserves.

i. Strategy

Although SIC does not state its own investment strategy, the SAFE website has provided general information for the public in the form of “Frequently Asked Questions” concerning the investment portfolio of its foreign exchange

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18 Id. at 3.
19 Id. at 27.
20 Id.
22 Id.
reserves. The information is vague, but it does provide an idea of how SAFE is investing. This article assumes that at least some of SAFE’s policy is applicable to SIC’s investment strategy, although it remains unclear exactly to what extent and in what manner.

As to the nature of its investments, SAFE affirms that it invests in international commodities like gold, precious metals, and petroleum as a means to diversify its portfolio, although it does so only to a limited extent. SAFE additionally states that it invests primarily in “assets related to governments, institutions, international organizations, and corporations in the developed and major developing countries, and mutual funds and various other products such as inflation-protected bonds and asset-backed securities” and acknowledges that with so much capital, it has moved beyond only high-grade investments in order to pursue various avenues of investment in which to puts its money.

In response to a question about lack of transparency of the management and operations of the foreign exchange reserves, SAFE responds that it has a “cautious attitude in terms of information disclosure and ... [will] gradually improve transparency in an active and steady manner.” As far as where SAFE invests, it has stated that it tries not to invest in the PRC as such measures would involve reconversion into renminbi, thereby negatively impacting the domestic economy.

In setting up its information sharing as a “Frequently Asked Questions” portion of its website, SAFE is able to co-opt the dialogue by creating both questions and answers suitable to it. For example, it asks itself, “Will China use its foreign exchange reserves as a trump card or as an atomic weapon?” Responding, it articulates how it sees itself as a “responsible long-term investor”

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23 FAQs on Foreign Exchange Reserves (I), STATE ADMIN. OF FOREIGN EXCHANGE, July 20, 2011, http://www.safe.gov.cn/wps/portal/english/News (click on “FAQs on Foreign Exchange Reserves (I)”) (explaining that SAFE limits its investments into these commodities and energy resources because such investments could potentially raise prices for consumers in China).
26 FAQs on Foreign Exchange Management Policies (I), STATE ADMIN. OF FOREIGN EXCHANGE, July 2, 2010, http://www.safe.gov.cn/wps/portal/english/News (click on “FAQs on Foreign Exchange Management Policies (I)”) (explaining that reconversion into renminbi would require the issuance of more domestic currency, which would further exacerbate the problem of surplus renminbi).
who “will not seek control” over investments that it makes.\textsuperscript{27} Another question acknowledges that the international community sees China’s “stockpile of foreign exchange reserves” as a sovereign wealth fund.\textsuperscript{28} SAFE responds by stating that “China adheres to independent management of its foreign exchange reserves.”\textsuperscript{29} According to SAFE, it has been using independent asset management companies, both domestic and foreign, to manage a portion of its foreign exchange reserves since 1996.\textsuperscript{30} Hence, as stated above, the exact proportion of SAFE’s reserves that SIC is managing remains unclear.

ii. Known Transactions

Nevertheless, certain investments that SIC has overseen have become public. In 2007, Costa Rica established diplomatic relations with the PRC and cut ties with Taiwan after 63 years of recognition of Taiwan’s sovereignty.\textsuperscript{31} In exchange, the PRC agreed to purchase 300 million USD in Costa Rican bonds in two equal instalments in January 2008 and January 2009.\textsuperscript{32} The agreement between the two countries explicitly links the purchase of the bonds to establishing diplomatic ties with the PRC. In letters between SAFE’s deputy administrator and Costa Rica’s finance minister, SAFE asks Costa Rica to perform “necessary measures to prevent the disclosure of the financial terms of this operation and of SAFE as a purchaser of these bonds to the public.”\textsuperscript{33} The transaction was only revealed after Costa Rica’s largest newspaper, La Nación, won a court case in which the judge ordered disclosure of the information.\textsuperscript{34} In order to effect the transaction, SIC set up Bo An Investment Company in Hong Kong on April 19, 2007, which is still registered as an active company today.\textsuperscript{35} It is a wholly owned subsidiary with SAFE officials acting as company directors. The company operates as a recipient of interest payments on the bonds.\textsuperscript{36} Establishment of

\textsuperscript{28} FAQs on Foreign Exchange Reserves (II), STATE ADMIN. OF FOREIGN EXCHANGE, July 25, 2011, http://www.safe.gov.cn/wps/portal/english/News (click on “FAQs on Foreign Exchange Reserves (II)”).
\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} Id. at 52.
\textsuperscript{33} Id. at 53.
\textsuperscript{34} Id.
\textsuperscript{35} Jamil Anderlini, Beijing Uses Forex Reserves to Target Taiwan, FINANCIAL TIMES, Sept. 12, 2008, http://www.ft.com/intl/cms/s/0/22fe798e-802c-11dd-99a9-000077b07658.html#axzz1c3AYRA3Z.
\textsuperscript{36} Id.
\textsuperscript{36} Company Name Search: Bo An Investment Company Limited, CYBER SEARCH CENTRE OF THE INTEGRATED COMPANIES REGISTRY INFORMATION SYSTEM, http://www.icris.cr.gov.hk/csci/cns_basic_comp.do (type Bo An Investment Company Limited in search box to get date of registration).
\textsuperscript{36} Anderlini, supra note 33.
another subsidiary like Bo An Investment Company demonstrates the possible mechanisms that SAFE and SIC can use to further obscure their investments.

SIC has also been linked to purchases of small stakes in 63 of the London Stock Exchange’s FTSE 100 companies. The investments are diversified, but the focus seems to be on energy, basic materials, and communications companies. SIC also invested $2.5 billion USD into the American company TPG Capital, which is one of the world’s largest private equity firms focused primarily on leveraged buyouts. TPG is well known for the largest leveraged buyout in history, which was conducted in 2007 to the tune of $43.2 billion for the acquisition of Energy Future Holdings Corporation, a Texas power producer. In January 2008, SIC attracted attention by buying stakes of less than one percent in three different Australian banks. Together, the investments totalled about 528 million USD. The banks were three of the four largest banks in Australia and each had been actively investing into the PRC. This article will use this investment as an example of an SWF investing into equity securities in a developed economy. Although the laws and regulations focused upon will only be those of Australia, general ideas of oversight of SWFs like SIC may be extrapolated by considering the obstacles that SIC needed to overcome when investing in the Australian banks.


40 Anderlini, supra note 33.
B. Current Oversight

1. Hong Kong Legislation Governing SIC

Article 18 of the Hong Kong Basic Law states that the law of the PRC does not apply in Hong Kong, with the exception of the twelve PRC laws, regulations, and resolutions listed in Annex III to the Basic Law. The Standing Committee of the National People’s Congress in the PRC has the power to amend this list, although it may only include laws “relating to defence and foreign affairs as well as other matters outside the limits of the autonomy of the Region as specified by this Law.” Currently, the laws in Annex III pertain primarily to PRC symbolism, nationality, the sea, and diplomatic privileges and immunities. As such, Hong Kong law governs SIC.

i. Restrictions on Capital Flows

Generally, Hong Kong has relaxed inward and outward foreign investment law and foreign exchange controls. Under Article 112 of Hong Kong’s Basic Law, Hong Kong is prohibited from adopting foreign exchange controls. There are also no limitations on the amount of foreign currency that may be moved into or out of Hong Kong or on the amount that may be kept in Hong Kong by residents or nonresidents. Additionally, there are no limitations on capital repatriation or remittance of profits and dividends. Hence, the process by which a foreign investor may move money into and out of Hong Kong is relatively unhindered. As such, SAFE experiences relatively few obstacles in moving money to its subsidiary and then moving money out of Hong Kong into investments.

ii. Company Law

As a subsidiary of SAFE and as a private company incorporated in Hong Kong, SIC is subject to Hong Kong’s Companies Ordinance. Under Section 29 of the Companies Ordinance, a “private company” is defined as one that includes in its articles of incorporation a maximum of up to 50 shareholders, a prohibition on invitations to the public to purchase equity or debt, and a restriction on the transfer of its shares. Under Section 121, accounts must be prepared, filed, and audited. Nonetheless, it is unnecessary for the company to provide public

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41 Xianggang Jiben Fa [Basic Law of the Hong Kong Special Administrative Region of the People’s Republic of China], art. 18 (H.K.).
42 Id. at Annex III.
43 Id. at art. 18.
44 Id. at Annex III.
45 Id. at art 112.
46 Companies Ordinance, (1933) Cap. 32 (H.K.).
47 Id. at s 29.
discussion of such accounts. Under Section 107, annual returns must be filed. There are also no restrictions on direct investment into Hong Kong and no limitations on foreign equity holdings in local firms. Hence, SAFE may wholly own SIC without a problem and with little necessary information that must be disclosed.

iii. Tax Law

In addition to complying with basic corporate law, SIC must also file tax returns to the Hong Kong Inland Revenue Department. Hong Kong is seen as a low tax jurisdiction by companies in many other countries because of its nominal tax rates and the absence of many taxes found in other jurisdictions, such as capital gains taxes, value-added taxes, and withholding taxes. Particularly advantageous for foreign investors is the fact that Hong Kong levies taxes based upon the “territorial principle,” which provides that only Hong Kong-based profits are subject to profits tax. Hence, if profit is derived outside of Hong Kong, a company does not incur tax liabilities in Hong Kong. Many companies around the world, including those in the PRC, consider Hong Kong a safe, stable, and friendly environment for storing money. In fact, investors located in the PRC constitute the highest percentage of investment into Hong Kong from abroad. This environment makes Hong Kong an attractive location from which to maintain and manage currency globally.

The combination of a lack of restrictions on capital flow, very basic applicable company law, and a near zero percent tax rate on profits makes Hong Kong an ideal locale from which SAFE can maintain investments and grow excess reserves in relative secrecy.

2. Australia’s Foreign Investment Regime as Applied in This Case Study

i. Foreign Investment Review

Australia employs a case-by-case review system in which any investment that may potentially be contrary to the national interest can be subject to review by authorities. In this system, the government has the ability to apply conditions to or

48 Id. at s 121.
49 Id. at s 107.
50 The exception is television broadcasting, in which foreign investors may only hold 10% of shares and represent up to 49% of voting shares. GOV’T OF INDIA DEPT. OF ECON. AFFAIRS, REPORT OF THE COMMITTEE ON LIBERALISATION OF FOREIGN INSTITUTIONAL INVESTMENT 34 (2004).
block a proposal that it finds against national security interests. Australia’s investment regime mandates that all foreign governments and their entities gain approval from the Australian government prior to making specific types of investments into Australia. The 1975 Foreign Acquisitions and Takeovers Act enables the Treasurer or a delegate to determine whether particular investment proposals might be contrary to national security interests. The Treasurer or delegate makes such decisions in cooperation with the Foreign Investment Review Board (FIRB) using Australia’s Foreign Investment Policy regulations for guidance.

According to Australia’s Foreign Investment Policy, foreign governments or their entities are defined as “companies or other entities in which foreign governments, their agencies or related entities have more than a 15 percent interest.” They are also defined as “companies or entities that are otherwise controlled by foreign governments, their agencies or related entities.” When reviewing an investment, the government assesses the investor’s character. In its Foreign Investment Policy, the government states that “proposals by foreign owned or controlled investors that operate on a transparent and commercial basis are less likely to raise national interest concerns than proposals from those that do not.” The government additionally states that it looks particularly for whether foreign government entities are operating on a fully commercial and arms-length basis, and if not, how and to what extent the investors’ operations might affect the national interest. Hence, foreign government entities’ ties to the government are carefully scrutinized. Their operations will only be reviewed, however, if the foreign investment review process is triggered.

The review process is triggered only if the investment has a certain character or is considered a direct investment. As such, foreign government entities must get approval when starting a business or acquiring interest in urban land. They must also get approval prior to making direct investments into Australia, regardless of the percentage stake of the investment. The Australian government defines a direct investment as any investment that may lead to some form of control over an enterprise. Namely, investments that involve contractual agreements for, *inter alia*, loans or provision of services, or that result in preferential, special or veto voting rights or the capacity to appoint directors, that are in preparation for a takeover bid, or involve enforcement of a security interest over a company’s shares or assets will need to be presented to the Australian government for approval prior to the transaction. This mandate exists regardless
of the size or nature of the target enterprise or the value of the transaction.\textsuperscript{60} If an investment does not appear to involve the acquisition of any form of control, then it need only be presented for review if it constitutes 10\% or more of the target entity.\textsuperscript{61}

In addition, the Foreign Investment Policy highlights specific statutory restrictions, which are placed upon investments in the banking sector, the Australian airline industry, Australian airports, ships registered in Australia, and Telstra, which is a telecommunications company that was originally state-owned but is now mostly privatized.\textsuperscript{62} The Policy notes that additional consideration may also be dedicated to investments in the media sector, transport industries, anything military-related or that could potentially be used for a military purpose, encryption and securities technology and systems, the operation of nuclear facilities, and the extraction or rights to extract uranium or plutonium.\textsuperscript{63} If competition issues arise, then the foreign investor will be subject to review by the Australian Competition and Consumer Commission pursuant to Australia’s competition laws.\textsuperscript{64}

ii. Domestic Securities and Banking Regulations

In Australia, the foreign investment regime serves as the barrier erected for foreign investors. Beyond it, however, are domestic regulations. When SIC acquired stakes in Australia’s banks, it dealt with banking and securities regulations. Under Australia’s securities regulations, if an entity winds up acquiring an interest of 5\% or more in any public company, then it must provide notice and details of the transaction to the market operator and the company in which it has gained the “substantial holding.”\textsuperscript{65} It should be noted that Australia’s Corporations Act does not specifically address how substantial shareholding notices should be handled when the “parent company” is a governmental organ. This situation is troubling in that a government like China’s can have several organs, each of which has subsidiary entities that are investing. As such, foreign investment review seems to be the sole regulatory detection mechanism for determining when a foreign government may be taking control of an investment. When investing in the banking sector, investors are additionally subject to Australia’s banking regulations and the Financial Sector (Shareholdings) Act of 1997, which prevents “practical control” in a bank by any shareholder and limits

\begin{itemize}
  \item \textsuperscript{60} Foreign Acquisitions and Takeovers Act 1975 (Cth) s 13A (Austl.).
  \item \textsuperscript{61} Foreign Investment Policy, supra note 53, at 12.
  \item \textsuperscript{62} Id. at 3.
  \item \textsuperscript{63} Id. at 14.
  \item \textsuperscript{64} Id. at 6. The primary governing law is the Competition and Consumer Act 2010.
  \item \textsuperscript{65} AUSTL. SEC. & INV. COMM’N, REGULATORY GUIDE 222 12-13 (2011). The Corporations Act 2001 Section 671B provides the general guidelines governing disclosure of a “substantial holding.” Corporations Act 2001 (Cth) s 671B (Austl.). The Regulatory Guide, promulgated by the Australian Securities and Investments Commission, was intended to clarify the disclosure scheme.
\end{itemize}
shareholding in banks to 15% unless approval is obtained from the Treasurer.\(^{66}\) When SIC invested in three different Australian banks in 2008, it became subject to this regime. Nonetheless, because the investments constituted less than one percent holdings in each respective bank, neither foreign investment review nor Australia’s securities or banking regulations were triggered.

In summary, SIC clearly falls within the scope of “foreign government entity” under Australia’s Foreign Investment Policy as it is wholly-owned by SAFE. Nonetheless, as long as SIC avoids taking stakes of 10% or more in any target enterprise or 5% or more in any public company, does not gain some form of control in any entity into which it invests, and stays away from sectors considered important to Australia’s national security, it can invest widely and relatively anonymously within Australia. Its investment into three of the four largest Australian banks illustrates that it can exercise discreteness and conduct transactions relatively undetected, even in a more regulated industry like banking and even in a relatively stringent foreign investment regime like Australia’s.

**C. Enforcement of Arbitration Awards in Hong Kong**

1. International Award Enforcement Agreements

Any conflicts arising from SIC’s investments will invariably involve private arbitration or the courts of the host country or Hong Kong. If an award is rendered and the claimant wants to pursue SIC’s assets in Hong Kong, then the Hong Kong court system will certainly be involved. Hong Kong adopted the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) first by virtue of the United Kingdom acceding in 1977 along with Hong Kong, and then by the PRC extending its own membership to Hong Kong in 1997.\(^{67}\) Mainland China and Hong Kong also have their own arrangement guaranteeing mutual enforcement of arbitral awards rendered in each territory.\(^{68}\) China’s Supreme People’s Court issued a Notice in December 2009 clarifying the legal grounds for and supporting enforcement in Mainland China of ad hoc arbitral awards rendered by foreign institutions in Hong Kong.\(^{69}\) Hong Kong’s domestic arbitration law is the Arbitration Ordinance, which went into effect at the beginning of 2011 and replaced an older arbitration law that explicitly differentiated between domestic and international arbitrations. Although the

\(^{66}\) *Financial Sector (Shareholdings) Act 1998* (Cth) s 8 (Austl.).


\(^{68}\) **HONG KONG DEP’T OF JUSTICE, ARRANGEMENT CONCERNING MUTUAL ENFORCEMENT OF ARBITRAL AWARDS BETWEEN THE MAINLAND AND THE HONG KONG SPECIAL ADMINISTRATIVE REGION 1 (2000) (H.K.).**

Ordinance has generally been well received by the arbitration community, it is apparent that there is substantial leeway for courts to take a second look at arbitration decisions at the enforcement stage in order to determine whether an award may be enforced in Hong Kong. This discretion carries implications for any party that wishes to enforce an award against SIC in Hong Kong.

2. Sovereign Immunity

In a recent case, the Hong Kong Court of Final Appeal held that an award cannot be enforced against SIC in Hong Kong or anywhere else in the world; on June 8, 2011, the Hong Kong Court of Final Appeal issued a decision aligning Hong Kong’s sovereign immunity policy with that of the PRC in the case *Democratic Republic of the Congo v. FG Hemisphere Associates.* The case raised the issue of whether Hong Kong should follow a restrictive or absolute doctrine of sovereign immunity. Until this decision, Hong Kong had continued to follow the restrictive doctrine of sovereign immunity, which it adopted from British common law. The restrictive model does not allow the protection of sovereign immunity to be extended to assets and activities that are commercial in nature. The PRC, however, follows a doctrine of absolute sovereign immunity, which provides protection to state-related entities, absent a waiver of sovereign immunity, regardless of whether the entity was acting in a commercial or sovereign capacity. In the case, the lower Court of Appeal held that Hong Kong would continue to follow the restrictive model. The Court of Final Appeal, however, embraced the PRC’s approach, thereby aligning Hong Kong with the PRC on the issue of sovereign immunity.

During the Court of Final Appeal’s review of the case, the Office of the Commissioner of the Ministry of Foreign Affairs in the Hong Kong Special Administrative Region sent an authorized letter to the court. The letter was couched in unequivocal terms and influenced the Court as its majority opinion was largely in accordance with the policies stated in the letter. The Ministry of Foreign Affairs clarified its own policy on sovereign immunity and its expectations of Hong Kong as follows:

> [T]he consistent position of China is that a state and its property shall, in foreign courts, enjoy absolute immunity, including absolute immunity from jurisdiction and from execution. The courts in China have no jurisdiction over any case in which a foreign state is sued as a defendant or any claim involving the property of any foreign state. China also does not accept any

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71 See generally Richard Hill & James Rogers, *Hong Kong: Decision on Immunity Not Absolutely Clear*, 6 GLOBAL ARB. REV. 4 (2011) (describing the Hong Kong courts’ holdings and analyzing the impact that the CFA’s decision will have on foreign investment and arbitration in Hong Kong).
foreign courts having jurisdiction over cases in which the State of China is sued as a defendant, or over cases involving the property of the State of China. The regime of state immunity concerns the foreign policy and overall interests of the state, and the above-mentioned state immunity regime adopted by China uniformly applies to the whole state, including the Hong Kong Special Administrative Region. 72

Therefore, this case has clarified the extent to which SIC and its assets are protected from courts, not only in Hong Kong but around the world. The implications at the award enforcement stage are that even if a party manages to get SIC into a court or arbitral proceeding, it will not be able to enforce any rendered award.

III. IMPLICATIONS

A. Why Should SIC’s Activities Be Regulated?

SIC has not signed onto the “Santiago Principles” and does not seem to be trying to comply with them. Therefore, there are no known soft laws guiding it. As it is a private limited liability company incorporated in Hong Kong, it is subject to very few corporate and tax laws. Furthermore, although litigation or commencement of arbitral proceedings against SIC might be possible with a contractual waiver of sovereignty, enforcement of any award against it is virtually impossible due to the PRC’s stance on sovereign immunity and SIC’s status as a wholly-owned subsidiary of SAFE. As such, there seem to be very few laws or regulations with which SIC must comply. Therefore, recipient countries are left to govern the activities of SWFs like SIC.

In summary, we have a case study of an SWF that is intended to represent an extreme example. It is a fund that appears to be dealing with a large sum of money in a covert manner and has relatively few laws and regulations applicable to it. Although lack of transparency does not necessarily mean that it is imprudently investing or using funds for overtly political reasons, it does hold important implications on the most basic level for the general public, both in recipient countries and within the PRC. For PRC citizens, SIC is investing the sovereign state’s excess foreign reserves. Losses on or mismanagement of investments can negatively impact domestic and global economies. Without disclosure of specific information about investments of the reserves, the Chinese public cannot hold the fund accountable. For recipient countries’ citizens, lack of information means that little is known about SIC’s intentions.

B. How Should SIC’s Activities Be Regulated?

The advantage of the Santiago Principles is that they were created and are being implemented by practitioners. As the “best practices” are coming from internal sources in the industry, they are more vague but also more realistic and perhaps can usefully serve as guidance for up-and-coming SWFs. Furthermore, meetings of the International Forum of Sovereign Wealth Funds, which was established by the International Working Group, enables SWFs to present a united front and lobbying effort when communicating with the public and recipient countries. Indeed, it was recently announced that advances have been made toward establishing a permanent secretariat funded by the members of the Forum so as to further facilitate this communication on a constant basis.73 These self-guiding mechanisms seem to be working well to provide reassurance to the many stakeholders involved in SWFs’ investments. They do very little, however, when an SWF does not identify as an SWF and does not participate in the Forum’s exchanges. Hence, in the case of an SWF like SIC, we are left with international investment treaties and recipient countries’ investment policies.

International investment treaties are particularly important for dispute resolution involving SWFs operated by states with absolute sovereign immunity stances. Such treaties may enable an arbitral panel to find that SWFs like SIC have waived sovereign immunity at the arbitration stage. With jurisdictions like Hong Kong, however, which do not have that many international investment treaties, this aid will only occasionally be available. Furthermore, it remains to be seen whether an SWF like SIC would be treated as the incorporated company that it is so that it may fall within the treaties’ definition of “investor,” or whether an arbitral panel may choose to take the unique nature of the SWF’s status as an investing arm of the government into account, thereby finding that the SWF does not fit into the meaning of “investor” intended by the participating states. As such, at the end of the day, international investment treaties may provide only nominal assistance in regulating SWFs like SIC.

Therefore, most of the work of oversight must be done by recipient countries’ investment policies. The disadvantage to a model of oversight almost solely reliant upon host states’ policies is that citizens in host countries with corrupt authorities or which are generally lacking in laws or regulations governing the types of complex investments that SIC might undertake are left vulnerable. Victims may very well have little or no recourse for invested projects that go awry or adversely affect them. In this type of scenario, both the host government and SIC might be able to avoid accountability. Nonetheless, the advantage to a model of oversight reliant upon recipient countries’ laws is that it allows each sovereign

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73 Changes in the IFSWF leadership and steps towards permanent secretariat, Int’l Forum of Sovereign Wealth Funds, May 12, 2011, http://www.ifswf.org/pr/pr7.htm [hereinafter IFSWF leadership]. This announcement was made at the third annual meeting of the Forum, which was hosted by the CIC — the PRC’s visible SWF — in Beijing.
state to craft its own policies on entry of SWFs. In creating its own regulations, the country can choose to balance how it plans to invite investments while still garnering enough information or mandating enough disclosure to protect itself, its citizens, and its businesses. Some countries that are particularly desperate for investments might punch more holes into their armour to let capital through. Other countries less in need of such investment might put up stronger walls. Policies can also more easily be changed in times of economic crises.

Australia’s policies offer a glimpse of one country that has established a carefully crafted foreign investment regime that welcomes foreign capital while still reserving the right to review investments that may affect the market and the country. In the case study provided, SIC was able to invest in Australia’s banks without disclosure as long as the investments remained below certain trigger points. The banks welcomed the investments and SIC was satisfied that it was able to conduct the transactions without disclosing much public information.

As a part of its Freedom of Investment process, the Organisation for Economic Cooperation and Development (OECD) has made inroads into gathering together and examining recipient countries’ foreign investment review policies and disclosure requirements. It has also been instrumental in advancing general “best practices” policies for fair, balanced treatment of SWFs. The collected information and “best practices” principles provide useful guidance to countries crafting their own investment policies. Nonetheless, the nature of the OECD as an organization of 34 developed countries has led it to focus primarily upon the concerns of those countries. As such, the set of economic issues and considerations addressed are limited by the nature of the data set. Many of the countries that are potentially most adversely affected by covert SWF activity have been left out of the dialogue and little guidance is available.

Since 2006, the OECD has been setting up roundtables as one component of its Freedom of Investment process, which involves all 34 OECD member countries, the eight non-member signatories to the Declaration on

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76 Building Trust and Confidence in International Investment (Paris: Organisation for Economic Co-operation and Development, 26 March 2009) at 3 (describing the purpose of the Freedom of Investment process as being to “help member and non-member governments to preserve and expand an open environment for international investment while also safeguarding essential security interests and taking action to recover from the current crisis”).
International Investment and Multinational Enterprises, other major non-members like China, India, and Russia, and occasionally some sovereign wealth funds (China, Qatar, and Russia). At the roundtables, countries peer review investment regulations and the issues arising from them. At the 10th Roundtable in 2009, participating countries committed to engaging non-member countries more deeply in discussions.

IV. CONCLUSION

Regulating SWFs like SIC involves communication between countries about how to craft thoughtful foreign investment review policies in order to avoid global financial repercussions. As this article has demonstrated, current international norms and agreements do little to facilitate oversight of SIC. As such, recipient countries are left with the task of trying to regulate financial behemoths like SIC. Although states differ greatly in the nature of their economies and resultanty have different foreign investment policies, dialogue between countries concerning “best practices” geared toward the unique nature of SWFs will enable countries to reflect on the balance they should strike between welcoming SWFs’ investments and protecting stakeholders. Hence, advances made by the OECD are a start. Nonetheless, communication between “like economies” on a regular basis as well as enhanced communication beyond the limited set of countries currently participating in the OECD’s efforts would be beneficial for addressing issues arising from SWFs’ investments.

78 IFSWF Leadership, supra note 73, at 5.
79 Id. at 13 (describing steps toward involving non-member countries and stating that “[d]evelopment of OECD investment instruments will be done as an inclusive process involving non-members as equal partners”).