**Remarks by**
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**on**

# Policy Principles for Sovereign Wealth Funds and Recipient Countries

**USCIB Briefing:**
**“Keeping Markets Open for Sovereign Wealth Fund Investment”**

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Thank you, Peter, for that warm introduction. It is a pleasure to join you today to discuss the importance of keeping markets open for foreign investment, a particularly timely topic given the current uncertainty in global financial markets. I would like to thank the U.S. Council for International Business for hosting this event and for its continuing interest in this important topic, and I also thank the co-sponsors and supporters of the event.

Before sharing my views on policy principles for sovereign wealth funds (SWFs) and recipient countries, let me first say a few words, by way of context, on the present challenges we face.

*Recent Developments*

We meet today in the midst of an historic reassessment of risk in the world's financial markets. The United States and other countries are taking steps to provide much needed liquidity to the financial system; strengthen financial institutions; protect investors; and enhance market stability. Just this past weekend, the G-7 countries committed to a plan of action to support systemically important financial institutions; ensure that financial institutions have access to necessary financing and can raise capital from public as well as private sources; and protect savers. Because the market turmoil is a global event, countries must continue to coordinate their actions and work within a common framework so that the action of one country does not come at the expense of others or the stability of the system as a whole.

In this time of heightened market uncertainty and fragility, it is imperative that we do not turn inward, but rather embrace trade and open investment policies. Allowing capital to flow freely is vital for economic growth and will enable healthy institutions to emerge from the current turmoil. Without access to capital, the engines of economic growth seize up and risk the health of the broader economy.

That being said, one clear lesson from this crisis is the importance of transparency and proper risk management in capital markets. In addition, sound regulatory frameworks must protect investors and maintain stability, while supporting the efficient functioning of markets. In this context, the work of the IMF-sponsored International Working Group of Sovereign Wealth Funds offers timely guidance for SWFs as they become increasingly significant actors in global markets. Similarly, as recipient countries consider policies to address capital market vulnerabilities, we are well-served to remember that openness to capital from abroad is a source of economic strength not economic vulnerability. Here, the OECD's work is particularly helpful. As some question whether rising protectionist sentiment is eroding countries' professed commitments to open investment principles, the OECD is providing needed guidance on what open investment means in practice.

*Sovereign Wealth Funds*

Sovereign wealth funds have received considerable attention in the past year, both for their growing importance as global financial market participants and for recent headline investments in major financial institutions. SWFs are not new, but their rapid growth in number and size is a relatively new development, and a trend that is expected to continue. SWF assets could reach $7-11 trillion in the next five years, from current estimated levels of $2-3 trillion. As SWFs invest internationally across a diverse range of asset classes, their rapid growth brings benefits, but also raises policy issues in recipient countries.

Earlier this year, I wrote an article for Foreign Affairs in which I laid out our "operating assumptions" with regard to sovereign wealth funds. They included the understanding that SWFs are, in principle, long-term investors, who historically have maintained their strategic asset allocation in the face of short-term volatility. SWFs typically are not highly leveraged. SWF managers generally have a higher tolerance for risk than reserve managers and seek higher returns by investing in a wider range of asset classes. In addition, sovereign wealth funds have access to, and frequently make use of, private fund managers, consultants, administrators, and custodians. SWFs as a group, but particularly the more longstanding funds, have a track record of making investment decisions on sound economic and financial grounds. A recently published Survey of SWF Institutional and Operational Practices confirms many of these assumptions.

Recognizing that better understanding and communication were needed on both sides of the investment relationship, Treasury made a point of fostering a constructive bilateral dialogue with a number of SWFs. As part of these efforts, Secretary Paulson reached agreement with Singapore and Abu Dhabi on a set of broad policy principles for SWFs and recipient countries in March of this year. These principles addressed issues surrounding sovereign wealth fund operations as well as recipient country inward investment regimes, consistent with our view that the two are closely linked.

While bilateral efforts are essential, Treasury has consistently taken the position that policy issues surrounding sovereign wealth funds - as well as recipient country inward investment regimes - are best addressed in a multilateral context. In that spirit, Treasury strongly advocated a multilateral approach to these issues, a call that was taken up by the IMF and the OECD.

*Generally Accepted Principles and Practices*

I will turn first to the work done by sovereign wealth funds. Answering a call from the G-7 and other member countries, the IMF facilitated the establishment of a group of 23 SWF countries, the International Working Group of Sovereign Wealth Funds or "IWG." The IWG agreed on a set of principles to guide SWF practices and objectives. The group welcomed input from recipient countries as it deliberated, demonstrating a collaborative spirit and a common interest in a credible product. The result is the Generally Accepted Principles and Practices or "Santiago Principles," which were drafted and agreed in less than half a year. This agreement represents a milestone in enhancing the openness and transparency of the global financial system and in promoting open investment worldwide.

The Santiago Principles were publicly released this past weekend following their presentation at the IMF and World Bank annual meetings. They are a voluntary framework, consisting of 24 principles and supporting commentary, which will guide SWFs in establishing sound practices in three key areas: 1) legal framework and coordination with macroeconomic policies; 2) institutional and governance framework; and 3) investment framework, including risk management.

Most critically, the Santiago Principles address many of the key macroeconomic, financial market, and investment issues raised by the rapid growth in the size and number of SWFs, as well as specific concerns highlighted by recipient countries, such as transparency and commercial orientation of SWFs:

. First, the Santiago Principles emphasize that SWF operations should be consistent with a sound macroeconomic policy framework, to address the concern that the formation of SWFs may perpetuate undesirable underlying macroeconomic and financial policies.

. Second, the Santiago Principles reflect commitments on the part of SWFs to disclose greater information about their institutional and operational practices, which will help reduce uncertainty and potential volatility in financial markets. These disclosures include financial information, including asset allocation, benchmarks, and historical rates of return; a description of the SWF's investment policy; the SWF's general approach to voting securities of listed entities, and optional public disclosure of actual votes ex post facto; and the SWF's risk management framework.

. Third, the Principles will help allay concerns that SWF investments are politically motivated, by emphasizing that SWFs should publish a clear statement regarding the SWF's policy purpose; make investment decisions aimed at maximizing risk-adjusted financial returns and based on economic and financial grounds; establish operational independence to protect investment decisions from political interference; and comply with regulatory and disclosure requirements of the countries in which the SWF invests.

Even before the Santiago Principles were released this week, they had already produced tangible results. The Government of Singapore Investment Corporation released its first public report a month ago on how it manages the Government's portfolio, including key information on its governance framework, investment processes, asset mix, and

long-term returns. Temasek, Singapore's SWF, already publishes detailed information annually. The Abu Dhabi Investment Authority has disclosed its broad asset allocation and is engaged in an ongoing process to enhance disclosure in all these areas, including compliance verification.

When Treasury first started looking at the issue of sovereign wealth funds in greater detail, there were a number of skeptics who doubted the willingness and ability of SWFs to come together and voluntarily agree on a set of principles. Their caution was justified, given the diversity of SWFs, the complexity of the issues, and the unchartered territory that the agreement represents for a number of these funds. That fact makes the IMF's efforts in convening and supporting the group's work, and IWG members' success in producing a credible product, all the more impressive.

*OECD Work on Recipient Country Policies*

Let me now turn to the work of the OECD, because, as mentioned earlier, there are two important sides to the investment equation. Consistent with the United States' longstanding commitment to open investment, we were early advocates for the OECD to identify a broadly-accepted set of principles to underpin open investment policies for countries that receive SWF investments. Our goal was to preserve and promote a global paradigm for the free flow of capital in the face of concerns being raised by the rapid growth of SWFs. The OECD was a logical home for this process, based on its significant existing body of work promoting open investment.

I understand Secretary General Gurria will discuss later the OECD's plans to finalize their work, so I thought I might focus my remarks on what the OECD has concluded to date, starting with its initial report issued in April, and how we view these principles through the prism of our own experience.

The U.S. Government has carried out significant reforms to the Committee on Foreign Investment in the United States (CFIUS), stemming from reaction to the Dubai Ports World transaction in 2006. Throughout this process, we have given a great deal of attention to explaining in detail our commitment to open investment and how that commitment plays out in practice in the CFIUS context.

I will begin with what is perhaps the foundational open investment principle: non-discrimination between domestic and foreign investors. This principle holds that countries should treat similarly domestic and foreign investors in like circumstances. When countries embrace this principle, both in law and in practice, they create conditions where the benefits of international investment can more easily be realized, namely job creation, innovation, enhanced productivity, and particularly relevant today, access to capital for domestic firms to grow and prosper.

Governments, of course, must be mindful of particular risks that may arise in some investments from abroad. Accordingly, OECD members have recognized that countries may apply the fundamental non-discrimination principle in a manner that permits addressing genuine national security concerns. Some countries employ extensive investment screening mechanisms, which consider broad factors such as "net benefit," "national interest," industrial policy, or other broad economic factors. In our view such expansive measures are too easily susceptible to, and sometimes actually serve, protectionist sentiment or goals. In the United States, we take seriously the narrow intent of the exception for national security and hue as closely to the non-discrimination principle as the facts of the case allow. CFIUS continues to focus solely on genuine national security concerns and reviews annually only a small portion of transactions - fewer than 10% of transactions involving a foreign investor and a U.S. business. In 2007, for example, there were over 2,000 cross-border deals, of which only 125 came before CFIUS, none of which was blocked.

A second and closely related principle identified by the OECD - regulatory proportionality - holds that countries should design measures precisely to address any particular national security concerns raised by a transaction, as opposed to blunt tools, such as sectoral restrictions, that may restrict or prohibit investments that are not problematic. CFIUS achieves this goal by considering transaction-specific risks and working with companies to resolve or mitigate any identified concerns.

The remaining two principles identified by the OECD - transparency and accountability - are perhaps where our reforms have been most extensive.

The transparency principle holds that governments should explain clearly how the investment review process works and what its objectives are, and then implement measures fairly and in a predictable manner. We have gone to great lengths the past few years to better explain the CFIUS process to domestic and international audiences. The President issued an Open Investment policy statement in May 2007, as did the G-8 at its summit in Heiligendamm, Germany, in June 2007. We also worked with Congress to craft the Foreign Investment and National Security Act (FINSA), which passed in July 2007 and became effective last October. That law and the President's related executive order are publicly available. Also, we held two public meetings to solicit input from stakeholders on implementation of FINSA, published proposed revisions to the 1992 CFIUS regulations, and accepted public comments on the proposed regulations. The comments are also publicly available on our website. We are in the process of considering all the comments we received during the comment period and will soon issue final regulations that further elucidate how CFIUS approaches key concepts such as `control' and numerous other issues raised by commenters. We will also soon publish additional guidance on the types of transactions CFIUS has reviewed and which have raised national security considerations. We have maintained CFIUS' procedural efficiency, including strict timelines, which increases predictability for investors. In 2007, CFIUS maintained the pace of concluding action on over 80% of transactions within one 30-day review.

Finally, the OECD identified the principle of accountability, which holds that governments should ensure proper oversight of implementing officials, while avoiding political interference in implementation. Accountability is key to ensuring both public and congressional confidence necessary for the system to function properly, without politicizing what should be technical decisions. The Congress and we achieved an outcome in FINSA that provides for higher-level accountability within CFIUS agencies, but considerably insulates CFIUS from political pressures by requiring detailed reporting to Congress only after CFIUS has concluded action on a transaction. High-level scrutiny, at no lower than the Assistant Secretary level, is required for all transactions, and certain CFIUS decisions must be certified at no lower than the Deputy Secretary level. As the OECD rightly notes, prohibiting a transaction is a drastic measure and such decisions should be taken at very high levels. Thus, FINSA maintains the requirement that only the President may prohibit a transaction, something that has only occurred once in the 20 years that CFIUS has been statutorily authorized.

*Conclusion*

We have made considerable progress in the past year to improve interaction between SWFs and recipient countries, but there is still work to be done. The excellent speakers who follow will help explore that important topic.

The Santiago Principles' effectiveness in helping to reduce protectionist pressures and contribute to global financial stability ultimately will depend on their widespread adoption and implementation by SWFs. We expect that the successor to the IWG - an international Standing Group of SWFs - will address implementation issues and proposals for further work. Ultimately, SWFs will be judged on how they apply the Principles in practice, especially in their investment decisions.

Likewise, the OECD can continue to play an important role in promoting open investment by monitoring and applying peer pressure where investment recipient countries fall short in living up to the principles laid out by the OECD.

And we expect the excellent communication between the OECD and the IWG to continue.

Success in these efforts, on both sides of the investment relationship, will build confidence - a sorely needed commodity in the present economic circumstances -and support an open and stable global financial system, in the best interest of the global economy.

Thanks again to the USCIB for hosting today's event. I regret that the need to return right away to a very active Treasury Department on this Columbus holiday prevents me from taking questions. But we very much look forward to continue dialogue with you on this important subject. Thank you for your kind attention.

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