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The False Panacea of International Agreements for U.S. Regulation of Sovereign Wealth Funds

*David A. Hall**

I. INTRODUCTION

Sovereign Wealth Funds (SWFs) pose a unique threat to the United States. Unlike other investment vehicles used solely to maximize returns, SWFs may invest for political objectives or strategic resource procurement, both of which are potentially harmful to U.S. interests. Countries such as China, Russia, and Saudi Arabia all have SWFs currently in operation in the United States, and the number of countries following this trend continues to rise.¹

Despite the economic and national security risks that SWFs pose to the United States, political institutions have largely ignored these investment vehicles, allowing them to move freely within the financial sector. Ironically, in 2006, politicians blocked the purchase of a U.S. port management company by a foreign state-owned company.² Such action seems inconsistent considering the arguably more sensitive nature of the U.S. financial sector; after all, if the government is concerned about the security of our ports, why not be equally concerned with the security of our economy?³

U.S. Securities and Exchange Commission (SEC) Chairman, Christopher Cox, stated that the rise of SWFs poses a challenge to regulators, implying a *need* to regulate SWFs.⁴ Solving this regulatory

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1. See Appendix A.

2. The failed takeover of a U.S. company by a foreign state-owned company illustrates the heterogeneous views of foreign governments investing in U.S. assets. See EDWARD M. GRAHAM & DAVID M. MARCHICK, U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT 136–43 (2006) (describing the politicization of the Committee on Foreign Investment in the United States' (CFIUS) review of the proposed title transfer of Peninsular and Oriental Steam Navigation Company to Dubai Ports World, which is owned by the United Arab Emirates).

3. See Robin Sidel, *Abu Dhabi to Bolster Citigroup with \$7.5 Billion Capital Infusion*, WALL ST. J., Nov. 27, 2007, at A3 (explaining that the Abu Dhabi investment authority does not have special ownership rights or a role in the management of Citigroup).

4. See Christopher Cox, Chairman, SEC, Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government: The Role of Government in Markets (Oct. 24, 2007), available at <http://www.sec.gov/news/speech/2007/spch102407cc.htm> (questioning the role of government investment funds in a public market as contrary to the

challenge is difficult, even with the existing international agreements signed or implemented by the United States because SWFs are investors and U.S. regulators generally do not regulate investors.⁵ Despite the increase in SWFs, many questions on how to regulate them remain unanswered by the extant literature. In particular, current works have failed to consider the legal issues surrounding regulation through international agreements, and the necessary modifications to increase the effectiveness of such agreements. This Comment argues that the legal and regulatory framework under currently applicable international agreements fails to effectively regulate SWFs and offers recommendations to modify and enhance the existing framework.

Part II defines SWFs, discusses the current state of SWF regulation by the United States, and introduces the defenses available and applicable jurisdictional bars to SWFs in the U.S. judicial system. Additionally, it examines the various international agreements that potentially affect U.S. regulation of SWFs and several of the risks posed by SWFs.

Part III demonstrates the infeasibility of sovereign action jurisdictional bars in U.S. courts. This Part then determines that the U.S. Model Bilateral Investment Treaty (BIT) and the International Organization of Securities Commissions Multilateral Memorandum of Understanding (IOSCO MOU) will not allow the SEC to effectively force disclosures from SWFs. Part III also examines the potential for indirect regulation of SWFs through financial intermediaries under the Basel II Accord and ultimately concludes that it offers minimal relief. Finally, Part III finds the International Monetary Fund (IMF) Articles of Agreement's role in regulating SWFs negligible at best.⁶

In Part IV, this Comment offers recommendations for the U.S. Model Investment Treaty, the capital adequacy requirements of the Basel II Accord, and specific changes for the IMF Articles of

regulatory philosophy of the United States).

5. See discussion *infra* Part II.C (discussing the regulatory approach to SWFs and the exceptions to a lack of regulation of investor behavior).

6. See discussion *infra* Part III.C (arguing that the IMF Articles of Agreement do not provide an effective means of forcing disclosures from SWFs because they are focused on exchange rates and utilizing the Special Drawing Right (SDR) as the principal asset for reserve holdings); cf. DENNIS R. APPELYARD ET AL., INTERNATIONAL ECONOMICS 725 (5th ed. 2006) (revealing that some refer to the SDR as "paper gold" because the IMF created the reserve assets "out of thin air"). The IMF utilizes a basket of currencies to determine the value of the SDR. *Id.*

Agreement. Ultimately, international agreements provide inadequate support for potential U.S. regulation of SWFs.

II. LEGAL AND REGULATORY CONTEXT

SWFs raise fundamental questions about whether the United States is willing to regulate investor activity and how such regulation would be carried out under international agreements.⁷ Moreover, they pose unique challenges to U.S. financial regulators who depend on foreign regulators for information about foreign violators of U.S. securities laws.⁸ Even after regulators have sufficient information to bring a claim against a noncompliant SWF, they must still overcome jurisdictional bars SWFs may raise to quash regulatory proceedings in a U.S. court.⁹

Any discussion of SWFs must be framed within the legal and regulatory context in which they operate. That context includes the following international agreements signed by the United States: numerous bilateral agreements to promote and protect investment,¹⁰ a multilateral information sharing agreement to better prosecute trans-border securities law violators,¹¹ and agreements to protect the stability of the international financial system.¹²

By way of background, this Part briefly introduces SWFs and

7. See 2004 U.S. Model Bilateral Investment Treaty, art. 3, <http://www.state.gov/documents/organization/38710.pdf> [hereinafter U.S. Model BIT] (providing for national treatment of foreign investors, which potentially implicates a regulatory scheme that singles out SWFs).

8. See generally Int'l Org. of Sec. Comm'ns [IOSCO], *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (May 2002), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf> [hereinafter IOSCO MOU] (revealing the need for international cooperation for the enforcement of securities laws).

9. See Philip J. Power, *Sovereign Debt: The Rise of the Secondary Market and its Implications for Future Restructurings*, 64 FORDHAM L. REV. 2701, 2727-41 (1996) (offering the application of jurisdictional bars in the sovereign debt context, which an SWF could utilize).

10. See Appendix C.

11. See IOSCO MOU, *supra* note 8.

12. Federal Reserve Board, Joint Final Rule and Supporting Board Documents: Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II, 7 (Nov. 2, 2007), available at http://www.federalreserve.gov/GeneralInfo/basel2/FinalRule_BaselII/FinalRule_Draft.pdf. [hereinafter U.S. Final Rule] (implementing the Advanced Capital Adequacy Framework in the United States); Second Amendment of Articles of Agreement of the International Monetary Fund, art. VIII, Apr. 30, 1976, 29 U.S.T. 2203, T.I.A.S. No. 8937, available at <http://www.imf.org/external/pubs/ft/aa/aa.pdf> [hereinafter IMF Articles].

discusses the risks they pose to the U.S. financial system, the current U.S. regulatory approach, and the sovereign immunity of SWFs and potential jurisdictional bars to claims against SWFs. This Part also examines international agreements that protect investors and the global financial network.

A. Risks Posed by Sovereign Wealth Funds to the U.S. Financial System

An SWF may present risks to the U.S. financial system in four main areas: (1) direct investment in U.S. publicly traded companies, (2) investment through alternative investment vehicles such as hedge funds and private equity groups, (3) the use of financial intermediaries to utilize modern finance techniques, and (4) the issuance of securities through a corporation it controls.¹³ While not necessarily discrete categories,¹⁴ they serve as a useful framework for understanding the challenges facing U.S. regulators. Keeping these fluid risk categories in mind, the opacity of SWFs leads to concerns about the motivation and purpose of their investments. Politicians and investors alike may question whether an SWF is investing for “economic returns, political objectives, [or] securing strategic resources.”¹⁵ As evidenced by the failed deal between the China National Offshore Oil Corporation (CNOOC) and Unocal,¹⁶ political considerations play into the concerns of regulators and the politicians who appoint them.¹⁷

Calls by SEC Chairman Cox for the regulation of SWFs demonstrate political concern over the current securities regulations,

13. For specific examples of SWFs from many different countries operating in these areas of the U.S. financial system, see generally MARTIN A. WEISS, CONGRESSIONAL RESEARCH SERVICE, SOVEREIGN WEALTH FUNDS: BACKGROUND AND POLICY ISSUES FOR CONGRESS (2008).

14. For instance, a Chinese SWF’s purchase of a less than ten percent stake in Blackstone, a U.S. private equity firm, demonstrates the fluidity of the categories because it represents the direct purchase of a U.S. company that also serves as an alternative investment manager. See Blackstone Group, L.P., Registration Statement (Form S-1), at 4 (June 11, 2007).

15. See *The World’s Most Expensive Club*, ECONOMIST, May 26, 2007, at 79 (arguing that the Chinese purchase of a stake in Blackstone could be understood as a political maneuver in response to growing protectionist sentiment).

16. See GRAHAM & MARCHICK, *supra* note 2, at 128–36 (contending that the attempt of CNOOC to purchase the U.S. oil company Unocal and the subsequent prevention by the United States Congress utilizing the CFIUS process was motivated by a political “perfect storm,” which included nearly record high oil prices, strong anti-Chinese sentiment, and Chevron’s attempt to purchase the company).

17. See *The World’s Most Expensive Club*, *supra* note 15.

which present little challenge to the operation of SWFs in the United States.¹⁸ The Securities Exchange Act of 1934 (1934 Act) requires an SWF to provide notice if it acquires beneficial ownership of more than five percent of a U.S. regulated company.¹⁹ This requirement leads to information disclosure, but not necessarily to regulation of the SWF.²⁰ SWFs face additional reporting requirements and activity restrictions if they acquire more than ten percent of a U.S. regulated company.²¹

Restrictions on SWFs that may benefit owners of U.S. regulated companies involve the purchase and sale of shares, but these provisions do not solve the problem of enforcing regulation across borders.²² Additionally, SWFs could leverage their position as insiders in their home countries to purchase securities before they are offered to the general public, and then resell them to U.S. investors through a financial intermediary or on the over-the-counter (OTC) market.²³ Finally, SWFs may expose themselves to liability by selling unregistered securities to U.S. investors through companies they control.²⁴ These regulatory provisions lack teeth because of the inability to enforce them.

18. See WEISS, *supra* note 13, at 8 (noting Blackstone CEO Steve Schwarzman's statement concerning the Chinese SWF purchase of a less than ten percent stake in that company as not needing government approval).

19. 15 U.S.C. § 78m(d).

20. *Id.* (requiring the disclosure of information by those owning more than five percent of a U.S. regulated company). See also Simon Johnson, *The Rise of Sovereign Wealth Funds*, 44:3 FIN. & DEV. (International Monetary Fund Sept. 2007) available at <http://www.imf.org/external/pubs/ft/fandd/2007/09/index.htm>.

21. 15 U.S.C. §§ 78m–n.

22. Compare 15 U.S.C. § 78n (creating a U.S. restriction on beneficial owner activities, but not providing a cross-border mechanism to enforce it), with IOSCO MOU, *supra* note 8, § 6 (acknowledging the ineffectiveness of cross-border enforcement without foreign regulator cooperation).

23. See 17 C.F.R. §230.501–506 (2008) (stipulating restrictions for the resale of restricted securities to unaccredited investors). It is also possible that foreign issuers besides SWFs could take advantage of insider trading due to lax foreign regulation.

24. See 15 U.S.C. § 77(e) (prohibiting the sale or delivery of unregistered securities through the means of interstate commerce); see also WEISS, *supra* note 13, at 8 (detailing the investments of the Chinese SWF, including its purchase of an investment company from a Chinese bank, demonstrating how SWFs could potentially purchase entire companies should it suit their investment objectives).

B. Introduction to Sovereign Wealth Funds -- Old Players with New Names and Modern Techniques

SWFs control large amounts of capital invested in the United States and are reluctant to disclose investment information.²⁵ SWFs with different mandates and motivations for investing pose risks different from those posed by other market participants, including hedge funds and institutional investors.²⁶ The subsections below offer a general overview of the purposes of SWFs and their operation in the financial system.

1. General overview of sovereign wealth funds

SWFs are not a new phenomenon,²⁷ but they have recently garnered more attention.²⁸ They are government-owned investment vehicles that invest in a country's reserve assets.²⁹ More specifically,

25. Cf. Stuart E. Eizenstat & Alan Larson, *The Sovereign Wealth Fund Explosion*, WALL ST. J., Nov. 1, 2007, at A19 (arguing that SWFs should disclose financial results and make clear that maximizing financial return drives investment decisions).

26. See *id.* (noting that pension funds, one kind of institutional investor, invest on behalf of pensioners while SWFs may invest to control strategic resources or bolster national companies).

27. SWFs have been around since at least the middle of the 20th century; there is disagreement, however, as to the precise moment of origination. Compare Philipp M. Hildebrand, Vice-Chairman, Swiss Nat'l Bank, Speech at the Int'l Ctr. For Monetary and Banking Studies: The Challenge of Sovereign Wealth Funds (Dec. 18, 2007) (positing that the first SWF began in 1816 when the government of France set up *Caisse des Dépôts*), with *The World's Most Expensive Club*, *supra* note 15 (stating that SWFs probably began inadvertently in 1956 with the Gilbert Islands and the British administration of Micronesia).

28. See Johnson, *supra* note 20. Johnson puts this figure in the context of U.S. GDP, which is \$12 trillion per year, and the total value of traded securities, which is approximately \$50 trillion. Compare *id.* (arriving at a \$10 trillion estimate for assets controlled by SWFs in 2012), with Cox, *supra* note 4 (proposing SWFs could control \$12 trillion by 2015); see also Johnson, *supra* note 20 (arguing the divergence in figures is not surprising as there is a "dearth of information" with respect to SWFs); see generally Bob Davis, *How Trade Talks Could Tame Sovereign-Wealth Funds*, WALL ST. J., Oct. 29, 2007, at A2 (analyzing the possibility of making SWF regulation a new topic for global trade talks); see generally Eizenstat & Larson, *supra* note 25 (discussing political concerns over SWFs which stem from the increasing amounts under the control of SWFs and the politically sensitive locations of some of the new SWFs being set up).

29. Cf. APPLEYARD ET AL., *supra* note 6, at 736 (noting the falling overall value of reserves relative to imports in the international financial system, but explaining that excess reserves result from exchange rate intervention). Reserves are a country's foreign exchange assets that accrue due to a trade surplus or undervalued exchange rate. *Id.* A country like China has a trade surplus with the United States, which means it exports more goods to the United States than it imports. *Id.* The revenue from exports brings more money into the country than leaves the country in terms of spending on imports. *Id.* In this example, if this trade imbalance persists, then the net exporting country builds up surplus dollars. *Id.* The Chinese state builds up these assets because it exchanges Chinese yuan with citizens who receive dollars in exchange

SWFs invest excess reserves³⁰ in assets denominated in another country's currency.³¹ In theory, the goal of SWFs is the long-term investment of excess reserves, while maximizing investment returns.³² SWFs differ from institutional investors like pension funds in that they generally have no explicit liabilities.³³ A pension fund's liabilities are the payments it must eventually make to its investors, at a greater sum than that originally received.³⁴

An SWF is an entity separate³⁵ from a country's central bank.³⁶

for the goods they exported. *Id.*

30. *See* *Em Ltd. v. Republic of Argentina*, 473 F.3d 463, 468 (2nd Cir. 2007) (describing an Argentine decree concerning excess reserves in a sovereign debt dispute). Excess reserves can also be understood as the amount of reserves in excess of what a country needs to cover its monetary base. *Id.* *See also* Johnson, *supra* note 20 (stating that "extra" reserves are those in excess of what a country feels are necessary for "immediate purposes"); A DICTIONARY OF FINANCE AND BANKING 140 (John Smullen & Nicholas Hand eds., 3d. ed. Oxford Univ. Press 2005) (declaring that excess reserves are undesirable and result from poor loan demand or high interest rates). Although countries differ in how they define their monetary base, they generally include some combination of money in circulation and demand deposits held by the central bank for financial institutions. *Id.* at 267–69.

31. *See* Hildebrand, *supra* note 27 (laying out the general approach of SWF investment choices, which tends toward foreign assets).

32. *See* Belinda Cao, *China's \$200 Billion Sovereign Fund Begins Operations (Update 1)*, BLOOMBERG, Sept. 29, 2007, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aGy8fzTT25.w> (reporting the statements of various Chinese officials involved with the creation of its SWF including that the SWF would keep tolerable risks in mind while investing).

33. *See* Hildebrand, *supra* note 27 (explaining that SWFs can act in a manner unfamiliar to regulators because they are not required to make specific payments, such as pension funds that pay pensioners at a delineated time); *see also* Edwin M. Truman, *Sovereign Wealth Funds: The Need for Greater Transparency and Accountability*, Policy Brief Number PB 07–6, 9 (Institute for International Economics, Aug. 2007) (positing that the idea that because SWFs have no explicit liabilities, they may resist pulling out of markets when there are economic downturns and help stabilize the international financial system). Truman questions the role SWFs will ultimately play in the international financial system. *Id.* *But see* WEISS, *supra* note 13 (noting that the Chinese SWF must service a debt load of \$40 million per day).

34. *See* Hildebrand, *supra* note 27, at 2 (arguing that this is a critical difference between SWFs and pension funds).

35. *See* *First Nat. City Bank v. Banco Para El Comercio Exterior De Cuba*, 462 U.S. 611, 628 (1983) (holding "the presumption that a foreign government's determination that its instrumentality is to be accorded separate legal status is buttressed by" the Foreign Sovereign Immunities Act); *see also* ROGNVALDUR HANNESSON, *INVESTING FOR SUSTAINABILITY: THE MANAGEMENT OF MINERAL WEALTH* 42 (2001)

(questioning the ultimate autonomy of an SWF in a democratic society because institutions are accountable to politicians and politicians are ultimately accountable to the populace, but stating that it should nonetheless be set up as an autonomous institution). SWF autonomy in a non-democratic society remains unclear, as the causal link between the institution and the populace is more tenuous than in a democratic society. *Id.*

36. *See* Ewart S. Williams, Governor, Central Bank of Trinidad and Tobago, Feature Address to the South Trinidad Chamber of Commerce Annual General Meeting:

The primary objective of an SWF is to maximize the risk/return equation (r/r equation).³⁷ A central bank's primary objective is to eliminate risk with little concern for the return on the investment.³⁸ In addition, because SWFs have a longer investment time horizon, they can diversify away from short-term liquid asset classes and invest in long-term illiquid asset classes.³⁹

Understanding the Heritage and Stabilization Fund, 1–2 (Sept. 20, 2007) *available at* <http://www.bis.org/review/r071004d.pdf> (elucidating that central banks hold reserves for prudential purposes and have liquidity as their chief consideration). Prudential concerns dictate that central banks invest in order to maintain the stability of the financial system under their care, and the implication of this concern is to focus on high liquidity when choosing its asset allocation strategy, i.e., central banks invest primarily in short to medium-term low-risk assets that are highly fungible with cash. *Id.* See also A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 330 (stating that banks with prudential concerns exercise an added degree of caution beyond covering their monetary base). Liquidity means the degree to which a bank can quickly exchange its assets for cash, or the financial system regards its assets as fungible with another currency. *Id.* at 239–40. Thus, high liquidity means that a bank can easily exchange its assets for cash, which is important in a financial crisis when the central bank needs to sure up the banking system by giving cash to banks. *Id.* Asset allocation is how a bank decides to allocate its capital between high and low liquid assets. *Id.*

37. See generally *Investing Concepts: Investing Basics*, The Motley Fool, <http://www.fool.com/school/basics/basics02.htm> (giving a basic definition of investment terms, which serve to illuminate the choice between risk and return leading to the implication that there is some restriction on SWF activity). The risk/return equation represents the essential choice that investors face; that is, whether they want more security in an investment with a lower rate of return, or a higher return and less security. *Id.* This choice is illustrated by the difference between securities, where there is the potential to lose all of the investment, but there is the possibility for tremendous appreciation, and relatively risk-free 3-month U.S. Treasury Bills that offer a lower rate of return. *Id.*

38. See Williams, *supra* note 36, at 3–4 (stating that nature or source of a country's excess reserves may dictate how an SWF maximizes the r/r equation). The Trinidad and Tobago SWF would not invest in assets directly related to oil and gas because this is the source of Trinidad and Tobago's excess reserves. *Id.* SWFs can maximize the r/r equation by shifting away from liquidity as their primary objective and investing in assets that produce a higher return, but are less liquid. *Id.* See also HANNESSON, *supra* note 35, at 40–43 (arguing that before a government sets up an SWF it must make a basic choice between investing in infrastructure, health, and education, or choosing to invest “in projects that are profitable on the basis of conventional market criteria”). Countries seek to provide funds as opposed to other investments for future generations. This allows future generations to spend the money as they see fit. *Id.* Cf. Keith Bradsher, *China Faces Backlash at Home Over Blackstone Investment*, INT'L HERALD TRIB., Aug. 2, 2007, *available at* <http://www.iht.com/articles/2007/08/02/opinion/backlash.php> (quoting one anonymous Chinese blogger who admonishes the government stating that “[t]he foreign reserves are the product of the sweat and blood of the people of China, please invest them with more care!”).

39. See Y. V. Reddy, Governor, Reserve Bank of India, Address at the Golden Jubilee Celebrations of the Foreign Exchange Dealers' Association of India: Forex Reserves, Stabilization Funds and Sovereign Wealth Funds – Indian Perspective, 1 (Oct. 8, 2007) *in* BIS Review, Nov. 3, 2007 *available at* <http://www.bis.org/review/r071009b.pdf> (explaining that a central bank's goal is to have sufficient reserves to cover its monetary base, whereas, SWFs are seeking a return higher than is necessary to preserve the real value of their reserves),

2. Fiduciary duty and modern financial techniques

Governments employ a series of techniques to circumvent potential conflicts of central bankers' interests. A central banker has the fiduciary duty to operate funds in the best interest of her country and would violate that duty if she allowed ever-increasing reserves to reside in low-yielding liquid assets.⁴⁰ Therefore, the government sets up a separate entity with different reserve management objectives, and the fiduciary duty to manage the reserves in the best interests of the country remains.⁴¹ In order to meet this fiduciary duty while maximizing the r/r equation, SWFs engage in many of the modern finance techniques that allow them to hedge some of their risk.⁴²

and Bradsher, *supra* note 38 (discussing that SWFs are still beholden to the public and must answer for poor investment decisions). The Chinese public expressed concern over unrealized losses by the Chinese SWF in its investment in the U.S. private equity firm Blackstone, and the speedy nature of the decision to invest in the U.S. alternative asset manager. *Id.* See also Williams, *supra* note 36 (explaining that to avoid contagion with potential domestic economic troubles, some SWFs limit their possible investment choices strictly to foreign investments). This concern leads to the strict prohibition against domestic investments by the Trinidad and Tobago SWF. *Id.*

40. See *The World's Most Expensive Club*, *supra* note 15 (showing the question becomes more pertinent as reserves mushroom because of the opportunity cost associated with unspent funds).

41. See HANNESSON, *supra* note 35, at 42–43 (arguing that there is an opportunity cost to creating an SWF with forgoing fiscal spending as the main downside cost, which raises the question of whether spending domestically, or saving in foreign assets is in the best interests of the country); see also Bradsher, *supra* note 38 (noting that the public may take a different view over how to invest a country's excess reserves).

42. See LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 677–78 (Aspen L. & Bus. 2001) (discussing the reasoning behind modern day investment techniques and offering a compelling reason why any financial market participant would utilize derivatives and futures investing tools). Loss and Seligman state that according to the efficient market hypothesis, which is a theory that the market will disseminate information broadly to all market participants, investors cannot out-trade each other because of superior information. *Id.* Investors then rely on portfolio theory, where they divide the risk in the portfolio into firm specific risk (“alpha”) and overall market risk (“beta”). *Id.* The diversification of assets virtually eliminates alpha risk, and investors manage beta risk according to their individual r/r equation, or asset allocation strategy. *Id.* Presently, some investors attempt to limit their beta risk by engaging in futures and derivative trades tied to stock indexes or underlying stocks. *Id.* There are two potential implications for SWFs: they may seek to gain superior information through improper means, or they will need to enter into contracts with banks in order to hedge their beta risk. *Id.* See also ROBERT A. HAUGEN, MODERN INVESTMENT THEORY 1 (5th. Ed., Prentice Hall 2001) (arguing that modern investment theory is widely practiced, which implies a broad dissemination of modern finance techniques). Setting up hedged positions through futures and options contracts is an integral part of modern investment theory. *Id.*; cf. A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 174 (defining a future as a contract to make a definite purchase of an asset at a set point in the future). An option is a contract whereby the option holder has the right to purchase an asset at a set price and predetermined date. A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 295.

SWFs are prone to the unique risks that accompany investments in foreign denominated assets.⁴³ SWFs enter into various contracts to hedge against the risk of currency devaluations, interest rate fluctuations, or simply using equity derivatives to hedge a position.⁴⁴ Thus, the SWF becomes a “counterparty” to an investment contract because it cannot hedge its positions alone.⁴⁵

C. Current U.S. Regulatory Approach to Sovereign Wealth Funds

SWFs, like hedge funds, are not regulated directly. The current approach to the regulation of SWFs and hedge funds⁴⁶ is to “watch carefully over the regulated intermediaries that lend to them.”⁴⁷ This is ineffective, however, because SWFs generally would not need to borrow large sums of money.⁴⁸ Their very existence suggests that the

43. See Williams, *supra* note 36 (arguing that because SWFs are diversifying away from possible domestic contagion they will necessarily be investing in foreign denominated assets and therefore facing additional risks because of the nature of these assets). See generally EZRA ZASK, ED., *GLOBAL INVESTMENT RISK MANAGEMENT: PROTECTING INTERNATIONAL PORTFOLIOS AGAINST CURRENCY, INTEREST RATE, EQUITY, AND COMMODITY RISK* (McGraw-Hill 2000) (offering frameworks that an SWF may use to mitigate the myriad risks inherent in foreign asset investment).

44. See LOSS & SELIGMAN, *supra* note 42, at 713–14 (stating that the use of derivatives to mitigate an investor’s exposure to the risk associated with foreign assets can create “substantial risks” for other market participants).

45. See A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 95 (defining a counterparty as “a party to a contract” and counterparty risk as “[t]he risk that either of the parties to a contract (counterparties) will fail to honor their obligations under the contract”); see also Norman Feder, *Deconstructing Over-The-Counter Derivatives*, COLUM. BUS. L. REV. 677, 722–25 (2002) (describing counterparty risk as a subset of credit risk and different from settlement risk, although, at least in the short term, both may result in the party to the transaction not being paid when it is time for settlement).

46. See The President’s Working Group on Financial Markets, *Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management 1* (April 1999) [hereinafter *Hedge Fund Report*] (arguing that many different types of investment vehicles fall under the definition of hedge fund). Hedge funds tend to “use leverage aggressively” and “pursue short-term investment strategies.” *Id.* at 2. See also CATHERINE TURNER, *INTERNATIONAL FUNDS: A PRACTICAL GUIDE TO THEIR ESTABLISHMENT AND OPERATION* 88 (Elsevier Ltd. 2004) (arguing that the first “true hedge fund” engaged in both short selling and leverage); cf. A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 236 (stating that leverage exists when the principal is small compared to the risks, i.e., a hedge fund uses a small portion of its own funds and borrows the rest to pay for a derivative position, thereby using a small amount of assets to create a highly leveraged position).

47. See Johnson, *supra* note 20 (stating that these regulated intermediaries are commercial and investment banks).

48. See *Hedge Fund Report*, *supra* note 46, at 1–2 (giving a working definition of hedge funds and noting their prevalent use of leverage to boost overall returns on capital); see also *supra* note 28 and accompanying text (discussing the cumulative size of SWFs and their potential for growth). It remains to be seen if the fiduciary duties that motivate an SWF to

countries which form them have excess cash.

The SEC would essentially be regulating investors if they were to attempt to regulate SWFs. This notion contradicts the ethos of the disclosure system created by the Securities Act of 1933 (1933 Act)⁴⁹ and the 1934 Act.⁵⁰ The SEC does regulate certain activities by investors, e.g., insider trading.⁵¹ The most pertinent of the regulations affecting investors is the five percent requirement under the 1934 Act, whereby an investor acquiring more than five percent of a company must file a statement with the securities issuer and the SEC.⁵² This statement discloses the investor's background, identity, residence, and the nature of the ownership, to the issuer and the SEC. Additionally, an investor may become an issuer⁵³ and receive

pursue higher returns will also motivate it to utilize leverage in a manner similar to hedge funds in an effort to boost their return on capital.

49. 15 U.S.C. § 77a-aa (2008).

50. *See generally* 15 U.S.C. § 78a-nn (2008) (providing for mandatory disclosures or abstention from the securities market when the sale or purchase of securities meets certain threshold requirements, such as a sale by insiders).

51. *See* 15 U.S.C. § 78j (prohibiting the use of manipulative and deceptive devices by "any person"). The inclusion of the phrase "any person" allows for the prosecution of people traditionally not considered insiders. *Id.* Rule 10b5-1 allows the SEC to prosecute a variety of individuals who engage in insider trading. 17 C.F.R. § 240.10b-5 (2008). *See* LOSS & SELIGMAN, *supra* note 42, at 855-56 (stating that rule 10b-5 of the '34 Act applies "whenever any person—insider or outsider—indulges in fraudulent practices, misstatements, or half-truths in connection with the purchase or sale of securities."). There are three arguments in favor of preventing insider trading: Equity, Allocative Efficiency, and Property Rights. *Id.* at 855-59. The Equity argument favors the proscription of trading while possessing material non-public information due to an "integrity of the market" theory where more investors will invest in a market that prevents insider trading. *Id.* at 857. The Allocative Efficiency argument is to remove the incentive to delay information disclosure. *Id.* at 858. The Property Rights argument views information as corporate property and is especially persuasive where corporations utilize their own resources to develop that information. *Id.* at 859. Of the three arguments presented by Loss and Seligman, the Public Confidence and Property Rights arguments are the better justifications for SWF regulation. SWFs have the potential to undermine public confidence because they may not have profit as their main motive, and they could utilize national intelligence resources to steal proprietary information to achieve a better return or avoid a loss. *Id.* at 857, 859.

52. 15 U.S.C. § 78m(d) (requiring persons owning more than five percent of any class of security to notify the issuer and the SEC). The notification must include: the purchaser's background, identity, residence, citizenship, and the nature of the ownership. *Id.* § 78m(d)(1)(A). Additionally, the purchaser must state the source of the funds, whether it intends to acquire control of the company, the number of shares that it owns, and any contracts or arrangements it may have concerning the issuer, including puts or calls. *Id.* § 78m(d)(1)(B)-(D).

53. *See* 15 U.S.C. § 77b(a)(4) (defining issuer as a person who issues any security); *see also* 15 U.S.C. § 77q(b) (requiring issuers to furnish certain information in their registration statement when issuing securities).

liability exposure⁵⁴ by selling unregistered securities through a company that it controls.⁵⁵ Finally, a beneficial owner, who is defined as a director, officer, or shareholder owning more than ten percent of a §12 company, is subject to a number of different provisions of the 1934 Act that potentially increase a beneficial owner's liability.⁵⁶

D. Testing the Sovereign Immunity of Sovereign Wealth Funds

Before delving into the international framework for regulating SWFs, it is necessary to understand the domestic context of bringing a foreign governmental entity under U.S. jurisdiction. In response to litigation brought on by U.S. regulators, an SWF would likely invoke one or all of the following three doctrines: sovereign immunity, the act of state doctrine, and international comity.⁵⁷ It is important to understand the judicial challenges before evaluating the effectiveness of any regulation through international agreements because it may render the entire discussion of U.S. regulation of SWFs through international agreements purely theoretical.

1. Restrictive theory of sovereign immunity

SEC Chairman Cox states that SWFs are not beyond U.S. jurisdiction when violating securities laws.⁵⁸ The Foreign Sovereign

54. See 15 U.S.C. § 77k (creating a private right of action for any purchaser of a security accompanied by a false registration statement).

55. See Blackstone Group, L.P., Registration Statement (Form S-1), at 4 (June 11, 2007) (filing a registration statement stating the Chinese SWF purchased a less than ten percent stake in the U.S. alternative asset manager, which suggests the SWF is attempting to limit its liability exposure).

56. See 15 U.S.C. § 78p(b) (creating monetary liability for beneficial owners who do not adhere to certain restrictions on the timing of sales or purchases of securities related to those that they own).

57. See Power, *supra* note 9, at 2723–41 (discussing the hurdles to suing a sovereign entity in U.S. courts in the context of sovereign debt defaults).

58. See Cox, *supra* note 4 (arguing that neither the Foreign Sovereign Immunities Act nor international law prevents the SEC from pursuing enforcement action against SWFs). The implication of Cox's statement is that SWFs fall within the commercial activity exception to sovereign immunity. *Id.* Additionally, he wonders whether the SEC would be able to follow its traditional approach of soliciting a foreign securities regulator's assistance in securing evidence to prosecute an SWF controlled by the very government from which the SEC is requesting assistance. *Id.* The U.S. Supreme Court supports Cox's assertion in its examination of a sovereign debt case holding, "[W]hen a foreign government acts, not as a regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are 'commercial' within the meaning of the FSIA." *Argentina v. Weltover*, 504 U.S. 607, 614 (1992); see also Power, *supra* note 9, at 2729–32 (analyzing the application of the Weltover decision to the sovereign debt crisis and its implication for sovereign immunity claims).

Immunities Act of 1976 (FSIA), codified the restrictive theory of sovereign immunity.⁵⁹ The restrictive theory states that there are exceptions whereby a court can exercise jurisdiction over a sovereign entity. The most widely noted restriction in FSIA limiting a foreign state's sovereign immunity, aside from an express waiver, is the commercial activity and property exception.⁶⁰

2. *Act of state doctrine*

The act of state doctrine is a judicially created rule that bars U.S. courts from determining the validity of a foreign state's official acts performed within its sovereign territory even when a U.S. court otherwise has jurisdiction.⁶¹ Unlike the case with sovereign immunity, the rule is not waivable.⁶² In order to qualify as a jurisdictional bar, the act of state doctrine requires that a U.S. court "declare invalid the official act of a foreign sovereign performed within its own territory."⁶³

3. *International comity*

Comity⁶⁴ is similar to the act of state doctrine in that it is not a

59. 28 U.S.C. §§ 1602–1611 (2008); see Power, *supra* note 9, at 2728 (positing that FSIA starts from the premise that foreign states are immune from U.S. court jurisdiction, but that it creates a number of exceptions, which gives rise to the "restrictive" theory).

60. 28 U.S.C. § 1602; see Power, *supra* note 9, at 2727–28 (stating that three kinds of activity implicate the commercial activity exception: 1) commercial activity in the United States; 2) acts "performed in the United States in connection with commercial activity carried on outside the United States;" and 3) acts "performed outside the United States in connection with a commercial activity carried on outside the United States, which act has a direct effect in the United States.")

61. See Power, *supra* note 9, at 2733–34 (giving various reasons for the rule and applications of it, e.g., the inability to grant effective relief, comity, and deference to the executive branch in foreign affairs).

62. *Id.* at 2732 (stating that "[t]he most important limitation on the doctrine's effectiveness [as a sovereign's defense] in collection actions is its requirement that the challenged act of state be performed within the sovereign's own territory"). With banking and investment decisions made through electronic communication it is necessary to consider the effects of an act because an analysis that an SWF official is in her country when phoning in an order would always result in the application of the act of state doctrine. *Id.* at 2734.

63. See *W.S. Kirkpatrick v. Envtl. Tectonics Corp.*, 493 U.S. 400, 404–05 (1990) (deciding that the act of state doctrine does not apply when a U.S. court does not need to pass judgment on the validity of a foreign sovereign's actions or where a plaintiff seeks to disregard a governmental action). The Court suggests in dictum that the act of state doctrine would not apply when comity or sovereign immunity do not apply to a transaction because of its commercial nature. *Id.* Additionally, the Court notes that even "modern" conceptions of international comity do not recognize sovereign immunity for commercial transactions. *Id.*

64. See BLACK'S LAW DICTIONARY 114 (3d Pocket ed. 2006) (defining comity as the

rule of law,⁶⁵ but comity differs in two key respects: (1) there is no territorial limitation for the doctrine of comity, and (2) the acts under consideration must be consistent with the laws of the United States in order for a court to apply the doctrine.⁶⁶ In essence, the doctrine is broader than the act of state doctrine, but the restriction that the action must be consistent with U.S. law and policy does not offer protection to those potentially violating U.S. laws.⁶⁷ An analysis of comity within the context of sovereign debt defaults demonstrates the limited usefulness of this doctrine to a would-be violator of U.S. law.⁶⁸

E. Sovereign Entity Status Will Not Bar the Jurisdiction of U.S. Courts

SWFs cannot shield themselves from the jurisdiction of U.S. courts through any of the doctrines outlined above. FSIA requires a two-step analysis to determine whether the commercial activity exception to sovereign immunity applies in a given situation.⁶⁹ The first step is to determine whether the activity is commercial in nature.⁷⁰ SWFs engage in an activity for the benefit of the state, but their activities are commercial in nature because they invest seeking a profit instead of investing to protect the financial stability of the country by maintaining liquidity.⁷¹ The second step is to determine whether the commercial activity is conducted in the United States or has a direct effect on the United States.⁷²

practice among different nations involving mutual recognition of each other's actions).

65. Power, *supra* note 9, at 2738; compare *Somportex Ltd. v. Philadelphia Chewing Gum Corp.*, 453 F.2d 435, 440 (3d Cir. 1971) (describing that comity is not a rule of law, but a judicial doctrine, which seems to imply some flexibility with its application), with *First Nat'l City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 762–65 (1972) (discussing the origins of the act of state doctrine within the United States and how it is not an inflexible doctrine).

66. See Power, *supra* note 9, at 2738 (applying the notion of comity to the sovereign debt crisis and finding it did not prevent a U.S. court's exercise of jurisdiction).

67. *Id.* at 2738–39.

68. See *id.* at 2738–41 (analyzing the utility of comity as a defense in sovereign debt defaults and finding that the debts would be inconsistent with U.S. policy—except in a case involving Costa Rica where the administration at the time expressed support for Costa Rica's policy—and thus, the defense would fail).

69. See 28 U.S.C. §1605(a)(2).

70. See 28 U.S.C. § 1603(d) (defining commercial activity and explicitly stating that the commercial nature of activities is to be determined by the nature of its course of conduct and not according to its stated purpose).

71. See *id.*

72. See Power, *supra* note 9, at 2728 (arguing that commercial activity in the United States, performed in connection with the United States, and acts affecting the United States

For an SWF investing in U.S. entities, its investments naturally have “substantial contact” with the United States because its investments would need to be in U.S. regulated entities to invoke the scrutiny of a U.S. regulator.⁷³ Thus, FSIA’s embodiment of the restrictive theory of sovereign immunity with its commercial activity exception clearly negates the use of sovereign immunity as a bar to U.S. court jurisdiction over SWFs.⁷⁴ SWFs seek to achieve a higher rate of return on the funds entrusted to it, and this necessarily implicates the commercial activity exception to sovereign immunity.⁷⁵

Any potential SWF transactions of concern to U.S. regulators would likely occur within the United States.⁷⁶ Repayment of sovereign debt, the closest analogy to the actors in an SWF transaction, is stipulated in a certain currency with payment designated in the country of the intermediary.⁷⁷ Possible incidents of insider trading, market manipulation, or irregularities with respect to large block trading likely result in a nullification of the act of state doctrine because the challenged action is not performed within the sovereign’s territory.⁷⁸ Whether there is nullification of the act of state doctrine likely depends on a contractual analysis determining the place of payment.⁷⁹ The act of state doctrine does not apply

will result in denial of sovereign immunity); *see also supra* notes 58–60 and accompanying text (discussing the restrictive theory of sovereign immunity and the conditions necessary for piercing the sovereign veil without an express waiver).

73. *See* 28 U.S.C. § 1603(c) (defining the United States as all territory “subject to the jurisdiction of the United States,” which implies that all entities subject to the jurisdiction of the United States fall within this definition).

74. 28 U.S.C. § 1602; *see Cox, supra* note 4 (stating that neither international law nor FSIA would render SWFs immune from U.S. jurisdiction).

75. *See Williams, supra* note 36 (emphasizing the difference between a central bank’s prudential management of reserves and an SWF seeking a higher rate of return).

76. *See, e.g., Cox, supra* note 4 (noting that should an SWF engage in insider trading it would adversely impact the SEC’s mission to protect U.S. investors).

77. *See, e.g., Power, supra* note 9, at 2735–37 (discussing the act of state doctrine and its application to the sovereign debt crisis of the 1980s where many Latin American countries defaulted on loans requiring intervention by the United States and other developed countries).

78. *But cf. id.* at 2733–34 (realizing that the act of state doctrine may apply where a court could not grant substantial relief, but courts routinely grant awards even when there is little chance of the party receiving it).

79. *See Citibank, N.A. v. Wells Fargo Asia Ltd.*, 495 U.S. 660, 666–67 (leaving undisturbed the District Court’s holding that repayment occurred where stipulated in the contract regardless of the location of collection). The Court of Appeals suggested that the “repayment” and “collection” are not divisible concepts, but ultimately upheld the decision because the parties stipulated a different branch location for collection. *Id.* at 666–68. *See also supra* notes 62–64 and accompanying text (discussing the requirements for the application of

when a foreign sovereign's official act is not at issue.⁸⁰ The possibility of a judgment barring repayment under the act of state doctrine increases the counterparty's risk in a transaction.⁸¹

SWFs challenge the notion of comity for financial regulators operating in an international context. Domestic regulators are faced with the bottom-line issue that when "government is both the regulator and the regulated . . . the opportunity for political corruption increases."⁸² In theory, comity calls for U.S. agencies to recognize the executive acts of other nations, but in practice, recognizing the executive acts of another nation may mean that the SEC is not able to fully prevent abuses by SWFs.⁸³

SEC Chairman Cox's concern about the government being the regulator and the regulated conjures up images of a monolithic government, one which simultaneously invests and regulates investors. However, this notion is imprecise as SWFs are specifically established as separate government entities.⁸⁴ Comity generally prescribes that U.S. agencies do not interfere with the inner workings of a foreign government, yet SWF participation in the U.S. financial system constitutes action that affects U.S. markets over which a foreign regulator exercises no control.⁸⁵ SWFs could not seek refuge under the principles of comity because their actions logically would be violations of U.S. law if the SEC seeks to enforce

the act of state doctrine).

80. See *Kirkpatrick*, 493 U.S. at 404–05 (suggesting that the act of state doctrine does not apply in a commercial context for sovereign entities).

81. Cf. *Feder*, *supra* note 45, at 723–24 (arguing that the insolvency of a counterparty would not necessarily cause an "out-of-pocket loss" to the "innocent party," but it would leave the innocent party without fulfillment of the contractual obligation it bargained for).

82. *Cox*, *supra* note 4.

83. Compare BLACK'S LAW DICTIONARY, *supra* note 64 (including mutual recognition of foreign executive action in its definition of comity), with *Cox*, *supra* note 4 (arguing that the lack of a severance between the regulator and the regulated undermines the SEC's confidence in the ability of that regulator to do its job effectively, and thus, undermining the concept of comity).

84. See *First Nat'l City Bank*, 462 U.S. at 628 (holding that there is a presumption of separate legal status for government created entities); see also *supra* notes 35–38 and accompanying text (noting that SWFs are set up as a separate entity from central banks because they are engaging in a different style of reserve asset management, whereas a securities regulator does not participate in the management of a country's reserves).

85. See *Spector v. Norwegian Cruise Line*, 545 U.S. 119, 120 (2005) (holding that a "clear statement of congressional intent" is needed before using a statutory requirement to interfere in the internal affairs of a foreign-flag vessel). The Court holds that it is reasonable to presume that interference with the inner workings of a state is not the intent of congressional action, but it is Congress' intent to regulate those actions that affect U.S. citizens. *Id.* at 121.

a securities law provision. Additionally, because there is no territorial limitation to comity, the SWF status as a foreign entity does not provide an exception to apply these principles.⁸⁶

F. Using International Agreements to Further the Mandate of Protecting U.S. Investors

In light of the U.S. domestic limitations on SWF, this Comment now turns to international agreements intended to protect U.S. investors. The SEC and the United States Trade Representative (USTR) both seek to protect U.S. investors but achieve their objectives in different manners. The USTR attempts to prevent foreign government interference in investments by U.S. investors.⁸⁷ In contrast, the SEC protects investors from fraudulent activity by companies operating domestically and abroad.⁸⁸ Despite their different approaches, both agencies recognize the importance of collaborating with other countries to achieve their respective goals.⁸⁹ This Comment next considers the U.S. Model Bilateral Investment Treaty and the International Organization of Securities Commissions Multilateral Memorandum of Understanding.

1. U.S. Model Bilateral Investment Treaty

Bilateral Investment Treaties (BITs) were implemented in the 1960s to provide “a stable international framework for the regulation of foreign direct investment.”⁹⁰ BITs are most effective in two key areas: (1) providing for the protection of investments, and (2) providing a forum for the resolution of investment disputes.⁹¹

86. See Power, *supra* note 9, at 2738–41 (noting the limited utility of comity as a defense when actions are inconsistent with U.S. policy).

87. See USTR, Summary of U.S. Bilateral Investment Treaty (BIT) Program, [http://www.ustr.gov/Trade_Agreements/BIT/Summary_of_US_Bilateral_Investment_Treaty_\(BIT\)_Program.html](http://www.ustr.gov/Trade_Agreements/BIT/Summary_of_US_Bilateral_Investment_Treaty_(BIT)_Program.html) [hereinafter Summary] (stating that the BIT program attempts to provide protection to U.S. citizens investing in countries that may lack effective investor protection).

88. See *generally* 15 U.S.C. §§ 78a–nn (creating a disclosure system for regulated companies in the U.S. market).

89. See *generally* IOSCO MOU, *supra* note 8 (providing a mechanism for the SEC to request information concerning its operations that may affect participants located in other countries).

90. See David Adair, Comment, *Investors' Rights: The Evolutionary Process of Investment Treaties*, 6 TULSA J. COMP. & INT'L L. 195, 197 (1999) (analyzing the evolution of investment treaties and how they serve to protect the individual investor unaccustomed to the risks of investing in foreign markets).

91. See *id.* at 198 (arguing that the BIT is a key improvement over the previous treaties

BITs serve as binding statements of international law that allow parties to seek redress from a third party arbitrator.⁹² The 2004 U.S. Model BIT is the most recent version of the template the USTR uses when it negotiates with foreign governments to create a bilateral investment treaty.⁹³ U.S. BITs provide investors with several benefits, including the assurance that foreign investments receive the same treatment as domestic investments.⁹⁴

2. The International Organization of Securities Commissions' Multilateral Memorandum of Understanding

The International Organization of Securities Commissions Multilateral Memorandum of Understanding (IOSCO MOU) is a non-binding arrangement between securities regulators to encourage information sharing concerning cross-border securities violations.⁹⁵ In addition to a number of foreign financial services regulators, the U.S. SEC and Commodity Futures Trading Commission (CFTC) are parties to the IOSCO MOU.⁹⁶ The signatories to the MOU pledge to exchange information in the investigation of securities and futures trading violations.⁹⁷ The IOSCO MOU serves as an example of regulatory equivalence rather than harmonization because the participants have no obligation to change their securities laws.⁹⁸

known as Friendship, Commerce, and Navigation Treaties ("FCNs"), which Adair regards as the "first step in the evolutionary process of the regulation of investment".

92. See U.S. Model BIT, *supra* note 7, art. 24 (allowing for submission of investment disputes to an independent arbitrator that adheres to international arbitration rules).

93. *Id.*

94. See Summary, *supra* note 87 (explaining the benefits of the BIT program). The other five benefits are: (1) they establish limits on the expropriation of investments, (2) they require market foreign exchange rates, (3) they "restrict the imposition of performance requirements, such as local content targets or export quotas," (4) they allow investors to choose their management, and (5) they provide international arbitration for the resolution of investment disputes. *Id.*

95. See IOSCO MOU, *supra* note 8, § 6(a) (emphasizing the parties' intent to mutually assist one another, but explicitly stating that the provisions are not binding).

96. Press Release, U.S. Commodities Futures Trading Comm'n (CFTC), U.S. Commodities Trading Commission Announces Participation in IOSCO Multilateral Enforcement MOU, CFTC 4851-03 (Oct. 16, 2003).

97. See *id.* (outlining the broad categories of offenses it seeks to prosecute using the IOSCO MOU). The MOU builds on 21 previous bilateral enforcement agreements signed by the CFTC. *Id.*

98. See Jorge E. Vinales, *The International Regulation of Financial Conglomerates: A Case Study of Equivalence as an Approach to Financial Integration*, 37 CAL. W. INT'L L.J., 1, 4 (2006) (arguing that equivalence is a more effective approach because different regulatory regimes can achieve similar goals without applying similar standards, thus allowing a foreign

G. International Financial System Agreements

Broadly, the international financial system is comprised of central banks, central monetary authorities, and the financial intermediaries that they regulate.⁹⁹ The Basel II Accord is the means by which central bankers coordinate the regulation of financial intermediaries, which allows those intermediaries to compete on a level playing field.¹⁰⁰ The IMF Articles of Agreement provide the means for countries to coordinate their exchange rate policies and to provide information about reserve management.¹⁰¹ Both of these agreements offer potential avenues for U.S. regulation of SWFs.

1. Basel II Accord

The Basel Committee on Banking Supervision (BCBS) created the Basel II Accord¹⁰² to fashion a more flexible approach to managing banks' capital adequacy in an effort to ensure the stability

regulator to determine that an information request does not comply with its standards, whereas harmonization would require regulatory regimes to have the same rules, thus requiring them to honor information requests); *see generally* IOSCO MOU, *supra* note 8, at 2 (stating that the purpose of the MOU is to ensure compliance with domestic laws). The IOSCO MOU is not a normative document and does not provide for prescriptive changes to individual signatories' regulatory regimes. *Id.*

99. *See* BARRY EICHENGREEN, *GLOBALIZING CAPITAL: A HISTORY OF THE INTERNATIONAL MONETARY SYSTEM* 75 (Princeton Univ. Press 1996) (indicating that central banks are the lenders of last resort for the banks that they regulate).

100. *See generally* Basel Committee on Banking Supervision (BCBS), *International Convergence of Capital Measurement and Capital Standards: A Revised Framework 2* (June 2004) [hereinafter *Basel II Accord*] (offering a greatly revised capital adequacy standard so that internationally active banks face the same regulatory standards instead of each country dictating its own reserve requirements to the banks it regulates).

101. IMF Articles, *supra* note 12.

102. *See* BANK OF INTERNATIONAL SETTLEMENTS (BIS), *THE BIS IN PROFILE* (Sept. 2007), *available at* <http://www.bis.org/about/profile.pdf>. (explaining that the BIS is a group of 55 central bankers and monetary supervisors, which have representation and voting at its General Meetings). The "Group of Ten" countries established the BCBS in the aftermath of a banking crisis in 1974. *Id.* *See also* A *DICTIONARY OF FINANCE AND BANKING*, *supra* note 30, at 189-90 (stating that the group originally began as a group of lenders for the IMF); BCBS, *HISTORY OF THE BASEL COMMITTEE AND ITS MEMBERSHIP*, (Jan. 2007), *available at* <http://www.bis.org/bcbs/history.htm> [hereinafter *HISTORY*]. Currently, it has thirteen members and is one of the five main committees of the BIS. *Id.* *See also* BIS, *MONETARY AND FINANCIAL STABILITY-OVERVIEW*, *available at* <http://www.bis.org/stability.htm> (describing the breakdown of the committees housed at BIS). While the BCBS is not a formal supervisory authority, it recommends standards and guidelines in an effort to have those implemented by the individual authorities. *Id.* *See also* *HISTORY*, *supra* (suggesting that it does not possess any authority is a bit of a misstatement because its members do have the authority in many instances to impose its decisions).

of the international banking system while not creating any competitive disadvantage for internationally active banks.¹⁰³ The Basel II Accord represents the efforts of its central bank and monetary authority members who utilize a soft law approach to promulgate their “principles and codes of conduct and best practices.”¹⁰⁴ Individual members of the BCBS implement the measures included in the Basel II Accord.¹⁰⁵ The Accord uses a “Three Pillar” system of protecting the international banking system from various risks by assuring that internationally active banks and their holding companies have reserved enough capital in case these risks materialize.¹⁰⁶ The Three Pillars are Minimum Capital Requirements, Supervisory Review Process, and Market Discipline.¹⁰⁷ The amount of capital a bank must set aside for a particular transaction depends upon with whom it is interacting, or, in other words, how big a capital charge a bank must take.¹⁰⁸

The key to the First Pillar, Minimum Capital Requirements, of the Basel II Accord is the credit assessment of the entities with which banks interact. An SWF’s potential classification under the Basel II

103. See generally Basel II Accord, *supra* note 100 (laying out its mandate of maintaining stability and competitive equality). The prevention of regulatory arbitrage and the force of the market may not allow regulators to make substantial changes in the BCBS’ Basel II Accord. See also U.S. Final Rule, *supra* note 12 (implementing the Basel II Accord in the United States, and noting that U.S. commentators reacted against changes from the BCBS proposals because the changes would likely impose higher costs, create competitiveness issues, and increase regulatory burden without improving overall safety and soundness).

104. Joseph J. Norton, *An Interim Filling the Gap in Multilateral, Regional, and Domestic Hard Law Deficiencies Respecting Financial Services within the Americas*, 12 LAW & BUS. REV. AM. 153, 159 (2006) (arguing that the soft law process may not work for other financial regulator “standard-setters” like the IOSCO MOU signatories).

105. Basel II Accord, *supra* note 100, at 1; see U.S. Final Rule, *supra* note 12, at 1 (stating that four agencies adopted the Basel II Accord in the United States due to their overlapping regulatory functions with respect to banking). These agencies are the Office of the Comptroller of the Treasury, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation. *Id.*

106. See Basel II Accord, *supra* note 100, *passim* (describing the composition and utilization of the three pillar system as an effort to provide a more efficient capital adequacy requirement). *Id.* at 6.

107. *Id.* at 6. The pillars are mutually supportive as the disclosures under the third pillar “effectively complement” the other two pillars by enforcing market discipline. *Id.* at 3. One of the keys to this approach is disclosure by banks of risks on their balance sheets. *Id.* at 6.

108. See *id.* at 15–47 (outlining the Standardised [sic] Approach to measuring credit risk). The credit assessment determines how much risk weight must be applied to claims on various types of entities. *Id.* The risk weight can range from 20% to 150% depending on the credit assessment of the borrower. *Id.* When a party has a better credit assessment the bank sets aside less capital and, therefore, can finance more deals because it is taking a smaller capital charge. *Id.*

Accord is as a Public Sector Entity (PSE).¹⁰⁹ Whether to give the SWF the same credit assessment as the sovereign, or as a normal commercial entity, is at the bank's discretion.¹¹⁰ SWFs engaging in atypical transactions when compared to the average sovereign borrower, or institutional investor, complicate the decision for banks.¹¹¹

2. *The IMF Articles of Agreement and disclosure requirements concerning foreign exchange reserves*

In addition to the Basel II Accord, the IMF is an organization that monitors the management of reserve assets by its members. Seemingly, it offers the primary mechanism for regulation of SWFs because they manage reserve assets. The IMF Articles of Agreement govern IMF operations and constitute a non-self-executing treaty in the sense that they do not create a private right of action.¹¹² Rather, they create a horizontal relationship between states.¹¹³

The framers of the IMF Articles of Agreement designed them for the post World War II exchange rate system with the U.S. dollar as the centerpiece of the system.¹¹⁴ Indeed, the use of the dollar as the centerpiece of the system led in part to the holdings of excess

109. *Cf. id.* at 15–16 (revealing that SWFs could be accorded the same treatment as the sovereign or the central bank, or because of their commercial nature could be treated as a normal commercial enterprise). This is a discretionary decision by the bank, and the bank would need to examine the specific institutional arrangement of the SWF and its relationship to the central bank. *Id.* For example, if the SWF were guaranteed a certain share of profits per year from a country's mineral resource production, then this may qualify as a specific revenue raising power, and allow the bank to more easily justify giving the SWF the same credit assessment as the sovereign or central bank. *Id.*

110. *Id.*

111. *See, e.g.,* Hildebrand, *supra* note 27 (demonstrating that SWFs do not need to raise funds; they need to invest funds).

112. *See* Sloss & Jinks, U.S. Chapter (forthcoming 2008) (manuscript on file with author) (stating that creating a private right of action is one of the three understandings of a non-self-executing treaty, and the other two are it “lacks the force of law, or that it is not judicially enforceable”); *see also* *Em Ltd. v. Rep. of Arg.*, 473 F.3d 463, 482–83 (2d Cir. 2007) (describing that the powers exercised under the IMF Articles of Agreement are sovereign in nature). Only sovereign states can sign the treaty and avail themselves of its resources. *Id.*

113. *See* Sloss & Jinks, *supra* note 112, at 6 (noting that the other two relationships are “vertical relationships between states and private parties, and private transactions between private parties.”). Thus, it makes sense that treaties predicated on horizontal relationships would be non-self-executing because they do not create private rights of action. *Id.*

114. *See generally* EICHENGREEN, *supra* note 99, at 93–135 (describing how the British members of the Bretton Woods Conference did not want the dollar to be the centerpiece, but relented in their demands).

reserves in dollar-denominated assets.¹¹⁵ It is in these assets that SWFs are now investing.¹¹⁶ The Articles of Agreement require that member states collaborate on exchange rate policy, which implicates the management of reserve assets, and that they share information regarding reserve assets.¹¹⁷

III. ANALYSIS

SWFs create multiple risk points within the U.S. financial system. Their status as a commercial entity prevents them from raising jurisdictional bars in the U.S. courts. However, current international agreements do not offer an effective means of regulating SWFs. The IOSCO MOU and the U.S. Model BIT are ineffective means of potential regulation and indeed could hinder effective regulation. Additionally, parties to these agreements generally do not control SWFs.¹¹⁸ Other international agreements that focus on the international financial system more broadly are equally ineffective. The structure of the Basel II Accord limits its usefulness, and political concerns generally prevent unilateral changes during its implementation.¹¹⁹ Furthermore, it is unlikely that the Federal Reserve can indirectly regulate SWFs via the Basel II Accord. Finally, the IMF Articles of Agreement are ill-equipped to deal with the realities of the post World War II financial system.¹²⁰

A. The SEC Cannot Effectively Regulate Sovereign Wealth Funds by Using the U.S. Model BIT or the IOSCO MOU

The current form of U.S. BITs (as epitomized by the U.S. Model BIT)¹²¹ is ill-prepared to deal with the risks posed by SWFs.

115. *See generally id.* (giving a history of the international monetary system and placing in context the role of the U.S. dollar as the principal reserve asset in the post World War II monetary system).

116. *See generally supra* text accompanying note 29.

117. *See generally* IMF Articles, *supra* note 12 (providing the general obligations of members to coordinate on exchange rate policy and to manage their reserve assets in line with Articles of Agreement).

118. *See* Appendices A–C (demonstrating very little overlap between the countries that have SWFs and the countries that are party to the IOSCO MOU or have a BIT in force with the United States).

119. *See infra* Part III.B (highlighting the challenges to making unilateral changes during implementation of the Basel II Accord by the United States).

120. *See infra* Part III.C (arguing that the IMF Articles of Agreement are a post World War II relic).

121. U.S. Model BIT, *supra* note 7.

The focus of BITs is protecting covered investments from expropriation by a foreign government,¹²² giving most-favored-nation (MFN) treatment to the other contracting party's investors,¹²³ guaranteeing repatriation of profits,¹²⁴ and settling disputes that cannot be resolved through consultation and negotiation.¹²⁵ Additionally, the U.S. Model BIT provides that foreign investors covered under the treaty shall be accorded national treatment in the establishment of investments.¹²⁶ These provisions may actually work against a U.S. regulator seeking to pursue legal action or impose restrictions on the actions of an SWF, for the reasons described below.¹²⁷

First, an SWF is defined as an enterprise according to the U.S. Model BIT;¹²⁸ it is treated the same as any other U.S. enterprise, meaning that a U.S. regulator may not single out SWFs for any specialized regulation without facing a potential investment dispute.¹²⁹ Current U.S. regulation to the analogous hedge fund is a hands-off approach.¹³⁰ The implication of national treatment is that U.S. regulators would need to treat SWFs in the same manner as hedge funds.¹³¹ U.S. regulators may circumvent the national treatment of foreign investors because the U.S. Model BIT permits

122. *Id.* art. 6.

123. *Id.* art. 4.

124. *Id.* art. 7.

125. *Id.* art. 24; see Calvin A. Hamilton & Paula I. Rochwerger, *Trade and Investment: Foreign Direct Investment through Bilateral and Multilateral Treaties*, 18 N.Y. INT'L L. REV. 1, 8-9 (2005) (describing these as the typical key provisions of BITs).

126. See U.S. Model BIT, *supra* note 7, art. 3, ¶ 1-3 (stating that the favorable treatment accorded to foreign investors needs to be the same as accorded to national investors and that those investors can either be juridical or natural persons).

127. See Hamilton & Rochwerger, *supra* note 125, at 1 (stating that BITs aim to protect investors from discriminatory regulation).

128. See U.S. Model BIT, *supra* note 7, art. 1 (defining an enterprise as either privately or governmentally owned, and organized for profit or not). This wide ranging definition captures the activities of SWFs. *Id.*

129. Compare *id.* arts. 3-5 (detailing the U.S. obligations as a host party, which include providing national treatment and a minimum standard of "fair and equitable treatment"), with *id.* art. 24 (providing for an aggrieved party to submit a claim to arbitration if articles three through ten are breached).

130. See Hedge Fund Report, *supra* note 46, at 1-2 (describing the variance of hedge fund activity, thus making it difficult to compare SWF activity to hedge fund activity). Note that the effectiveness of this approach is limited by the difference in SWF behavior as compared to hedge funds because hedge funds tend to aggressively use leverage. *Id.*; see also *supra* notes 46-48 and accompanying text (discussing the U.S. approach for hedge fund regulation).

131. See U.S. Model BIT, *supra* note 7, art. 3(2) (requiring the same treatment for foreign investors that the United States accords to U.S. investors, which includes hedge funds).

the prevention of transfers of capital related to investments so long as they apply the law in an “equitable, non-discriminatory, and good faith” manner.¹³² The application of certain domestic laws may be allowed under the U.S. Model BIT, but that does not prevent an SWF from seeking arbitration.¹³³ Finally, the U.S. Model BIT provides no impetus for foreign regulators to aid U.S. regulators by providing information regarding SWF activities.¹³⁴

The IOSCO MOU seems to be the SEC’s best option for pursuing an SWF and forcing SWF disclosures, but the MOU lacks effectiveness for two reasons: (1) it does not create a legally binding obligation,¹³⁵ and (2) a foreign regulator can deny a request for assistance on the grounds of an essential national interest.¹³⁶ These deficiencies are understandable when considered within the context of the harmonization versus equivalence debate.¹³⁷ Harmonization requires two countries to have the same rules to achieve the same goals whereas equivalence allows for different rules to achieve the same goals. Forcing an information exchange may contradict a country’s regulatory regime preference.¹³⁸ The regulatory regime

132. *Id.* art. 7, ¶ 4. The U.S. Model BIT allows the United States to prevent the transfer of dividends or other investment returns to SWFs that violate “laws relating to:

- (a) bankruptcy, insolvency, or the protection of the rights of creditors;
- (b) issuing, trading, or dealing in securities, futures, options, or derivatives;
- (c) criminal or penal offenses;
- (d) financial reporting or record keeping of transfers when necessary to assist law enforcement or financial regulatory authorities; or
- (e) ensuring compliance with orders or judgments in judicial or administrative proceedings.”

Id.

133. *Id.* art. 24.

134. *Id.* arts. 18–19 (allowing for the denial of information request due to “essential security interests,” or on the less onerous ground that it may “prejudice the legitimate commercial interest” of a public enterprise).

135. *See* IOSCO MOU, *supra* note 8, § 6(a) (stating as a general principle that the MOU does not supersede domestic laws).

136. *See id.* § 6(e)(iv) (recognizing the importance of information sharing, but eviscerating its effectiveness by allowing countries to evade a request on the basis of public or essential national interest).

137. *See* Vinales, *supra* 98, at 4 (noting that the two concepts are not mutually exclusive as the U.S.-E.U. approach to the harmonization of accounting standards started with equivalence). The two are mutually exclusive, however, because equivalence ceases to exist when there is regulatory harmonization. *Id.*; *see also supra* text accompanying note 98.

138. *See* Vinales, *supra* note 98, at 56–57 (noting that the Swiss authorities pay lip service to information exchanged concerning financial conglomerates, but stringent legal hurdles remain before a Swiss authority can relay information to a foreign regulator even when an agreement such as the IOSCO MOU is in place).

preference is difficult to untangle from a country's political or strategic motives when deciding to share information about an SWF's investment activities.¹³⁹ Without the legal imperative, it would be difficult to elicit a foreign regulator's support for U.S. regulation of that country's SWF.¹⁴⁰

B. Dashed Hopes for Indirect Regulation by the Federal Reserve Through Basel II Implementation

SWFs invest the excess reserves of their home countries.¹⁴¹ It is unlikely that they will participate in the financial system in the same manner as sovereign debt borrowers.¹⁴² U.S. regulators can promulgate regulations forcing financial intermediaries to apply pressure to SWFs by requiring banks to take a higher capital charge for their interactions with SWFs.¹⁴³ The typical interaction between an SWF and an internationally active bank is likely to be an off-balance sheet item¹⁴⁴ for the bank involving counterparty risk, to which the BASEL II Accord does not apply a specific risk

139. See IOSCO MOU, *supra* note 8 § 6(e)(iv) (allowing for the rejection of information requests based on national security provides an opportunity for rejecting the request based on nebulous reasoning).

140. See Cox, *supra* note 4 (questioning the resolve of governments to cooperate with a fraud investigation when the target of the fraud is an SWF controlled by the same government). Compare Appendix A (listing the major SWFs in existence), with Appendix B (listing the signatories to the IOSCO MOU). Note that there is very little overlap between the two lists, thus the effectiveness of the IOSCO MOU is limited as a tool to regulate SWFs. *Id.*

141. See *supra* notes 25–39 and accompanying text (laying out the essential features of the SWF).

142. Cf. Michael Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*, 101 AM. J. INT'L L. 711, 711 (2007) (noting that debt instruments are a popular means for governments to raise funds). Governments that have the resources to set up an SWF would be less likely to interact with internationally active banks with respect to debt issuance as the government is not seeking to raise funds, but to invest its excess reserves. *Id.*

143. Compare U.S. Final Rule, *supra* note 12, at 66–69 (noting the objections of many commentators to proposed changes in the Final Rule for implementation of the Basel II Accord including claims that the changes would leave U.S. regulated banks at a competitive disadvantage compared to foreign regulated banks), with discussion *supra* notes 102–08 and accompanying text (discussing the implementation of Basel II Accord in the United States and elsewhere through a soft law approach). The soft law nature of the Basel II Accord allows countries to make changes to the rules as they implement them. *Id.*

144. See A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 290 (defining an off-balance sheet instrument as a derivative transaction that a bank does not have to disclose on its balance sheet, which allows banks to hide their exposure to SWF risks). Derivatives are financial instruments with their price determined by underlying financial instrument and are useful for hedging risk. *Id.* at 113.

weighting.¹⁴⁵

A unilateral move by U.S. banking regulators to require banks dealing with SWFs to take a higher capital charge could result in a drift from SWFs utilizing U.S. regulated banks, resulting in less income for those banks.¹⁴⁶ Thus, unilaterally imposing a higher capital charge leaves U.S. regulated banks at a competitive disadvantage to non-U.S. regulated banks.¹⁴⁷ Furthermore, the higher capital charge does not necessarily prevent SWFs from dealing with a non-U.S. regulated subsidiary of a U.S. regulated bank.¹⁴⁸ From a legal standpoint, U.S. banking regulators are free to change the requirements of the Basel

II Accord because its provisions are non-binding.¹⁴⁹ From a practical standpoint, with the institutional momentum of the Basel II Accords, it is not a viable option for U.S. regulators to make substantive changes during the implementation of the Basel Accords.¹⁵⁰

145. See Basel II Accord, *supra* note 100, at 22 (“Counterparty risk weightings for OTC derivative transactions will not be subject to any specific ceiling.”). There are provisions for dealing with short-term commitments such as letters of credit collateralized by the underlying shipment, repo-style transactions with other banks, etc. *Id.* The Basel II Accord, however, deferred a decision on how to handle counterparty credit risk with respect to unsettled securities and foreign exchange transactions, and left it to the banks to decide how to mitigate their credit exposure in this area. *Id.*

146. See U.S. Final Rule, *supra* note 12, at 41–42 (stating that foreign subsidiaries of U.S. banks can avail themselves of “host jurisdiction definition[s] of default for retail exposures of the foreign subsidiary in that jurisdiction”); see also Joel P. Trachtman, *Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation*, in REGULATORY COMPETITION AND ECONOMIC INTEGRATION 290–91 (Daniel C. Esty & Damien Geradin, eds., Oxford Univ. Press 2001) (arguing that allowing foreign subsidiaries to choose host jurisdiction regulation would create a situation “imposing no substantive obligations” on issuers because they would move to seemingly regulation-free states).

147. See U.S. Final Rule, *supra* note 12, at 66–69 (noting the concerns of commentators reacting to the proposal to change aspects of the U.S. Final Rule away from the requirements set forth in the Basel II Accord, and indicating that it would leave U.S. regulated banks at a competitive disadvantage when compared to non-U.S. regulated banks).

148. *Cf. id.* at 41–42 (differentiating between the approach for the wholesale transaction category, which cover SWFs, and retail transactions where the U.S. banking regulators explicitly note that foreign subsidiaries of U.S.-regulated financial institutions may follow their home country’s rules for allocating risk assessments to counterparties).

149. See Lawrence C. Lee, *Integration of International Banking Supervisory Standards: A Blueprint for the Taiwanese Banking System*, 19 ANN. REV. BANKING L. 455, 460 (2000) (commenting that the purpose of the Basel Accords is not to create legally binding agreements and that in order for the agreements to be effective, they are dependent upon national-level implementation and enforcement).

150. *Id.* at 460–61 (suggesting that the Basel Accords should apply to all financial intermediaries). It is arguable that because of the interconnectedness of the financial system the Basel Accords do apply to most if not all of the financial institutions in some respect. *Id.*

C. The IMF Articles of Agreement -- A False Panacea

There is a tension between applying the restrictive theory of sovereign immunity and utilizing the IMF Articles of Agreement to regulate SWFs. The restrictive theory of sovereign immunity treats the government entity as a commercial actor, while the non-self-execution doctrine implies that actors under the IMF Articles of Agreement are sovereign entities.¹⁵¹ Distinguishing between a sovereign's actions and a sovereign's independently created agency is difficult, especially in the case of SWFs.¹⁵² SWFs invest a country's excess reserves¹⁵³ but claim to seek a profit.¹⁵⁴ This mixture of resources and motives leads to their muddled status with respect to the IMF Articles of Agreement. FSIA defines SWFs as commercial actors stripped of their sovereign status, yet the IMF Articles of Agreement cover sovereign actions, which seemingly makes these two views irreconcilable.¹⁵⁵

IMF members are obligated to collaborate on policies concerning reserve assets as seen in Article VIII, section seven.¹⁵⁶ This would seemingly require members to collaborate on matters concerning SWFs, but the thrust of the Articles of Agreement is to promote international liquidity by making the Special Drawing Right (SDR) the principal reserve asset, which the IMF framers assumed would replace the U.S. dollar's position in the world today.¹⁵⁷ Article 8, section seven seeks to prevent the use of capital controls that harm

151. *Compare* *Argentina v. Weltover*, 504 U.S. 607, 614 (1992) (holding that the restrictive theory of sovereign immunity results in the classification of some government entities as commercial actors), *with* *Em Ltd. v. Rep. of Arg.*, 473 F.3d 463, 482–83 (2d Cir. 2007) (holding that the powers under the IMF Articles of Agreement, i.e., reserves management, are sovereign in nature).

152. *Cf.* Paul L. Lee, *Central Banks and Sovereign Immunity*, 41 COLUM. J. TRANSNAT'L L. 327, 364 (noting that a series of appellate cases demonstrated an "aversion to overriding the presumption of independent status for separate corporate agencies or instrumentalities.>").

153. *See Em Ltd.*, 473 F.3d at 482–83 (holding that managing reserves is sovereign in nature).

154. *See supra* notes 40–42 and accompanying text (explaining the fiduciary duty of SWFs and the need to maximize the r/r equation).

155. *See* 28 U.S.C. § 1605(a)(2) (piercing the sovereign veil for the commercial activities of foreign states).

156. *See* IMF Articles, *supra* note 12, art. VIII, § 7 (including the word "and" in between the provision for collaborating with respect to reserve asset management and the promotion of the SDR as the principal reserve asset provision, thus creating a dual obligation).

157. *Id.*; *see generally* EICHENGREEN, *supra* note 99 (arguing the momentum of the U.S. dollar prevented the SDR from assuming the U.S. dollar's place in the international monetary system).

international liquidity regardless of the general obligation found in this section to collaborate regarding exchange rate policy.¹⁵⁸ Additionally, the goal of making the SDR the principal reserve asset makes it clear that Article VIII, section seven intends to promote collaboration with respect to some reserve asset policies but not at the expense of harming international liquidity.¹⁵⁹

Reporting measures defined by Article VIII, section five are inadequate because they only require a broad view of a country's investment activities. Section five governs the furnishing of information because not all countries have accepted the use of the SDR as a principal reserve asset.¹⁶⁰ Subsection VII requires disclosure of a country's international investment position, but this is a macroeconomic measure and does not provide specifics about a country's individual investment decisions.¹⁶¹ Other provisions of section five require members to provide similar macroeconomic data.¹⁶² Most members of the IMF currently furnish such data but are not required to furnish information about the investments made by SWFs.¹⁶³ Nominally, the IMF Articles of Agreement offer false hope as a means to regulate SWFs by mandating disclosures. The IMF Articles of Agreement did not contemplate a post World War II financial system where countries not only hold reserve assets but utilize them for investment purposes.

158. See IMF Articles, *supra* note 12, art. VIII, § 7 (stating that the aim of the mutual collaboration is to promote international liquidity and not specifically to monitor member's reserve asset management).

159. See *id.* (demonstrating that liquidity is the primary goal, which is understandable in a post World War II era where concern focused on capital and current account controls, and not investment by states).

160. *Id.* art. VIII, § 5 (requiring member countries to provide information concerning gold and foreign exchange holdings, which would be unnecessary if countries only held SDRs as reserve assets).

161. *Id.* art. VIII, § 5(vii); see APPLEYARD ET AL., *supra* note 6, at 459–63 (giving an overview of the international investment position of countries and stating that it is a macroeconomic indicator that does not provide specific information on micro-level management of reserves).

162. See generally IMF Articles, *supra* note 12, art. VIII, § 5 (describing the various responsibilities of member governments under the treaty, and conspicuously absent is any provision where a member would need to provide specific data concerning its investment position).

163. See IMF, The Data: Coverage, Periodicity, and Timeliness, <http://dsbb.imf.org/Applications/web/sddsdatadimensions/> (last visited Sep. 29, 2008) (providing the categories of statistics that governments provide under the Special Data Dissemination Standard, which does not require countries to provide the type of data necessary to reduce transparency concerns about SWFs).

IV. RECOMMENDATIONS

Although the current structure is flawed, the best approach to regulating SWFs is through adjustments to the existing framework. The international agreements outlined above offer little help to U.S. regulators concerned with SWF activity affecting the United States. Either the agreements do not include the necessary participants to make them useful, or they lack the provisions to make them effective.¹⁶⁴ Even those agreements that are non-binding prevent the United States from unilaterally making changes to them.¹⁶⁵ Making changes to the existing framework is more time-effective whereas negotiating a multilateral investment framework would be very time-intensive. This Comment offers recommendations for changes to the U.S. Model BIT, including modification to disclosure requirements, and to the Basel Capital Adequacy Standards and the IMF Articles of Agreement.

A. Recommendations for the U.S. Model BIT

The U.S. Model BIT offers the United States the best hope for regulating SWFs. Currently, its provisions block attempts to single out an SWF for regulation separate from that which governs a domestic entity. Utilizing the U.S. Model BIT remains a hypothetical approach to SWF regulation because there are no countries with SWFs that have agreed to a U.S. BIT.¹⁶⁶ This approach would require negotiation of a treaty and would allow the other party to request concessions from the U.S. government.

1. Include information sharing provisions similar in scope to the IOSCO MOU

Including a package of provisions similar to the IOSCO MOU in the U.S. Model BIT could allow the United States to bind other countries to provide information on SWFs when requested by U.S. regulators.¹⁶⁷ The scope of the requirement to provide information

164. Compare Appendix A (listing the countries that control SWFs), with Appendix B (providing scant overlap with Appendix A), and Appendix C (presenting the ineffectiveness of the BIT as a tool for SWF).

165. See *supra* notes and accompanying text 146–150 (elucidating the challenges of unilaterally changing the Basel II Accord during U.S. implementation).

166. See Appendix C (demonstrating the need to negotiate with other countries because the current U.S. BITs are with countries that do not have SWFs).

167. See *supra* notes 16–18 and accompanying text (determining the effectiveness of the

would need to include a detailed accounting of foreign investments in the United States. This requirement would need to be binding, which is the major drawback with respect to the IOSCO MOU.¹⁶⁸

2. *Single out government investment vehicles*

Currently, the MFN and national treatment of countries allow for government entities that engage in commercial activities to receive the same treatment as a publicly held company.¹⁶⁹ The United States should recognize that SWFs pose greater risks than the average foreign investor does and should single out SWFs in the U.S. Model BIT.¹⁷⁰ Information requests about SWFs should not be denied because of national security. They are operating in a commercial sphere and should be treated accordingly.¹⁷¹ The USTR should probably be prepared to accept some level of hedge fund regulation as a compromise to their demands for the U.S. Model BIT to single out SWFs. By doing so, the USTR could maintain the overall goal of BITs to provide equal protection of foreign and domestic investors.

B. Modification of the Basel Capital Adequacy Standards

The next revision to the Basel Capital Adequacy Standards should include provisions that recognize SWFs as a separate entity from the central bank and accord them different treatment. Currently banks can elect to treat SWFs as having the same creditworthiness¹⁷² as the central bank.¹⁷³ Allowing banks to elect

IOSCO MOU with respect to the regulation of SWFs). *But see* IOSCO MOU, *supra* note 8, at § 6(a) (showing the MOU could only serve as a starting point because its language is intended to be non-binding and allow for a country to deny an information request based on national interest). Allowing a country to deny an information request in a revised BIT context would undermine its effectiveness and render it as useless in the context of regulating SWFs as the IOSCO MOU. *See id.*

168. *See* IOSCO MOU, *supra* note 8, § 6(a) (stating that the MOU is non-binding).

169. *See* U.S. Model BIT, *supra* note 7, arts. 3–4 (requiring similar treatment between foreign and domestic investors).

170. *See supra* note 28 and accompanying text (detailing the comparative size of SWFs).

171. 28 U.S.C. § 1605(a)(2) (removing sovereign immunity for commercial activities by sovereign actors).

172. *See* A DICTIONARY OF FINANCE AND BANKING, *supra* note 30, at 100 (defining creditworthiness as a measure of an entity's ability to repay debt, which in the case of SWFs should be relatively high considering they are flush with cash and other highly liquid instruments).

173. *See supra* notes 109–10 and accompanying text (showing the discretion given to banks concerning SWFs).

how they treat SWFs with respect to the capital charge removes any leverage that a regulator could potentially apply to financial intermediaries in hopes of garnering disclosures about SWFs' investment decisions. The United States cannot unilaterally change the regulations for the banks it manages because an SWF could simply utilize a foreign subsidiary of the same bank over which the United States does not have control.¹⁷⁴ As such, capital adequacy standards should be modified for financial intermediaries dealing with SWFs that do not adhere to a specified level of transparency.

C. Specific Changes for the IMF Articles of Agreement and a Plan for Their Implementation

In addition to the IMF developing a set of best practices for SWFs,¹⁷⁵ making simple changes to the IMF Articles of Agreement could make it easier to obtain information about SWFs. First, adding "individual investment positions"¹⁷⁶ as a category of reporting to Article VIII, § 5(a)(i) would make this provision useful for those seeking more transparency from SWFs.¹⁷⁷ Second, adding "with the exception of government sponsored investment vehicles"¹⁷⁸ to the second line of Article VIII, § 5(b) would add the obligation that members report data with sufficiency to cover SWFs.¹⁷⁹

The United States and Western Europe could entice other IMF members to accept the changes in exchange for enhanced voting

174. See discussion *supra* Part III.B (analyzing the issues concerning unilateral changes to the Basel II Accord by the United States).

175. See Truman, *supra* note 33, at 9 (stating that the IMF or World Bank could wait for governments to enlist their assistance, or they could take the initiative and establish a code of best practices); see also Clay Lowery, Acting Under Secretary for International Affairs, U.S. Treasury, Remarks at the Federal Reserve Bank of San Francisco's Conference on the Asian Financial Crisis Revisited: Sovereign Wealth Funds and the International Financial System (June 21, 2007), available at <http://www.frbsf.org/banking/asiasource/events/2007/0706/papers/lowery.pdf> (calling for the IMF and World Bank to lead with a set of best practices, but also stating that there is a need to review foreign direct investment to protect national security without creating undue barriers).

176. The revised provision would read as follows: "i) Official holdings at home and abroad of (1) gold, (2) foreign exchange, and (3) individual investment positions."

177. IMF Articles, *supra* note 12, art. VIII, § 5; see Truman, *supra* note 33, at 8 (discussing the IMF's special data dissemination standard (SDDS), which provides for a greater detail of reserve composition reporting). Many countries go beyond the minimum standards of SDDS and report their reserve management strategies as part of their SDDS reports. *Id.*

178. The revised provision would read as follows: "b) Members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed with the exception of government sponsored investment vehicles."

179. IMF Articles, *supra* note 12, art. VIII, § 5.

rights.¹⁸⁰ Currently, control of the IMF is concentrated in those Western powers.¹⁸¹ However, the countries controlling the IMF generally do not have SWFs. In contrast, countries with a disproportionately small share of voting rights control many SWFs. By exchanging SWF disclosure for enhanced voting rights, the IMF can become more democratic and create a relevant role for itself in the 21st century.¹⁸²

V. CONCLUSION

The SEC and other U.S. regulators lack the tools to effectively regulate SWFs. Since SWFs are treated as investors, they enjoy many of the benefits granted to others in their class. Most of the SEC's tools are framed around protecting investors rather than regulating them. The disclosure regime of the SEC is focused on issuers and certain insiders. Thus far, SWFs have not fallen into either of these categories because they have elected not to appoint directors, have remained under the 10% threshold of ownership after which an investor must file a disclosure with the SEC as a beneficial owner, and have not become issuers.

As demonstrated, the international agreements to which the United States is a party, offer little relief from the shortcomings of the domestic system. They provide no additional means of forcing disclosure from SWFs. Additionally, the pursuit of securities law violators in an international context necessarily predicates the cooperation of foreign regulators, though this may be easier said than done when the arm's length distance between the regulator and the regulated breaks down. Understanding the legal context of regulating SWFs supports the conclusion that the discussion surrounding regulation has less to do with the law and more to do with politics.

180. *Cf.* APPELYARD ET AL., *supra* note 6, at 749 (calling for greater transparency of IMF decision making).

181. *Id.*

182. *Id.*

APPENDIX A:
COUNTRIES WITH SOVEREIGN WEALTH FUNDS¹⁸³

Australia
Brunei
Canada (Alberta)
China
Kuwait
Libya
Micronesia
Norway
Qatar
Russia
Saudi Arabia
Singapore
South Korea
United Arab Emirates
United States (Alaska)

183. Compiled from: HANNESSON, *supra* note 35; Hildebrand, *supra* note 27; *The World's Most Expensive Club*, *supra* note 15.

APPENDIX B:
IOSCO MOU SIGNATORIES¹⁸⁴

Alberta Securities Commission (SC), Alberta
Australian Securities and Investments Commission (ASIC), Australia
Central Bank of Bahrain (CBB), Bahrain, Kingdom of
Banking, Finance and Insurance Commission, Belgium
Bermuda Monetary Authority, Bermuda
British Columbia Securities Commission (BCSC), British Columbia
Financial Services Commission of the British Virgin Islands, British
Virgin Islands
China Securities Regulatory Commission, China
Czech National Bank, Czech Republic
Denmark Financial Supervisory Authority (Finanstilsynet), Denmark
Dubai Financial Services Authority (DFSA), Dubai
Financial Supervision Authority, Finland
Autorité des marchés financiers, France
Bundesanstalt für Finanzdienstleistungsaufsicht (BAFin), Germany
Capital Market Commission (CMC), Greece
Securities and Futures Commission, Hong Kong
Hungarian Financial Supervisory Authority, Hungary
Securities and Exchange Board of India (SEBI), India
Financial Supervision Commission, Isle of Man
Israel Securities Authority (ISA), Israel
Commissione Nazionale per le Società e la Borsa, Italy
Financial Services Agency (FSA), Japan
Jersey Financial Services Commission (FSC), Jersey
Jordan Securities Commission (JSC), Jordan
Lithuanian Securities Commission, Lithuania
Commission de surveillance du secteur financier of Luxembourg,
Luxembourg
Securities Commission of Malaysia, Malaysia
Malta Financial Services Authority (MFSA), Malta
Comisión Nacional Bancaria y de Valores (CNBV), Mexico
Conseil déontologique des valeurs mobilières (CDVM), Morocco
The Netherlands Authority for the Financial Markets (AFM),
Netherlands, The

184. Int'l Org. of Sec. Comm'ns [IOSCO] *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (May 2002) app. A, available at http://www.iosco.org/library/index.cfm?section=mou_siglist.

Securities Commission of New Zealand (SC), New Zealand
Securities and Exchange Commission of Nigeria (NSEC), Nigeria
The Financial Supervisory Authority of Norway (Kredittilsynet),
Norway
Ontario Securities Commission (OSC), Ontario
Polish Securities and Exchange Commission (PSEC), Poland
Comissão do Mercado de Valores Mobiliários (CMVM), Portugal
Autorité des Marchés Financiers, Québec
Monetary Authority of Singapore, Singapore
The National Bank of Slovakia, Slovak Republic
Financial Services Board (FSB), South Africa
Comisión Nacional del Mercado de Valores (CNMV), Spain
Securities and Exchange Commission, Sri Lanka
Capital Markets Board (CMB), Turkey
Financial Services Authority (FSA), United Kingdom
Commodity Futures Trading Commission (CFTC), United States
Securities and Exchange Commission (SEC), United States

APPENDIX C:
COUNTRIES WITH BILATERAL INVESTMENT TREATIES WITH THE
UNITED STATES¹⁸⁵

Albania	Jamaica
Argentina	Jordan
Armenia	Kazakhstan
Azerbaijan	Kyrgyzstan
Bahrain	Latvia
Bangladesh	Lithuania
Bolivia	Moldova
Bulgaria	Mongolia
Cameroon	Morocco
Congo, Democratic Republic of (Kinshasa)	Mozambique
Congo, Republic of (Brazzaville)	Panama
Croatia	Romania
Czech Republic	Senegal
Ecuador	Slovakia
Egypt	Sri Lanka
Estonia	Trinidad and Tobago
Georgia	Tunisia
Grenada	Turkey
Honduras	Ukraine
	Uruguay

185. Trade Compliance Center, Bilateral Investment Treaties Currently in Force as of Feb. 2, 2009, http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp.