



## SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

Dear Ministers,

I am pleased to present to you the OECD Investment Committee's report on "Sovereign Wealth Funds (SWFs) and Recipient Country Policies". This report was prepared in response to the request of the G7 Finance Ministers and other OECD members last fall, for us to develop guidance for recipient countries' policies toward investments from these funds. The OECD addressed this request as part of an ongoing project on Freedom of Investment and National Security, which was launched in view of the rise of investment protectionism and to maintain open markets.

The report is the result of the work of the thirty OECD countries, fourteen non-member countries participating in the project and the European Commission, and benefited from consultations with SWFs and the business and social partners. I believe that this process is already helping to create a much better understanding of the issues involved for recipient countries, and I have no doubt that it will also help facilitate the work underway in the IMF for best practices by SWFs.

Our findings show that these funds bring benefits to home and host countries and that existing OECD investment instruments are well suited to develop guidance for countries receiving investments from SWFs. These instruments call for fair treatment of investors. They commit adhering governments to the principles of transparency, non-discrimination, liberalisation and standstill, and to build this fair treatment into their investment policies. They provide for "peer review" of adhering countries' observance of these commitments.

The OECD investment instruments also recognise the right of countries to take actions to protect national security. Investments by SWFs can raise concerns as to whether their objectives are commercial or driven by political, defence or foreign policy considerations. In our report, the participants in the Freedom of Investment project agree that recipient countries should apply the national security clause of the OECD investment instruments with restraint. They have agreed on a number of key principles – transparency and predictability, proportionality and accountability – that should guide governments when they design and implement investment measures to address national security concerns. These principles should also apply when dealing with investments from SWFs.

Observance of high standards by SWFs and their provision of adequate and timely information will facilitate recipient countries' efforts to implement their OECD commitments and its recommendations for preserving open markets while safeguarding national security. IMF findings on best practices for SWFs will be welcome in this regard.

The OECD will continue its work on how governments can maintain their commitment to open international investment policies – including for SWFs – while also protecting essential security interests. The resulting framework will foster mutually-beneficial situations where SWFs enjoy fair treatment in the markets of recipient countries and these countries can confidently resist protectionism pressures. To this end, the spirit of co-operation that has characterised these discussions to date will continue through consultation and dialogue between home and recipient countries and between the IMF and the OECD.

We will present the results of our work to the OECD Ministerial Meeting next 4-5 June. The final report of the Freedom of Investment project will be released in Spring 2009.

We look forward to continuing to work with you on this very meaningful project.

Sincerely,

A handwritten signature in black ink, appearing to read 'Angel Gurría'.

Angel Gurría  
OECD Secretary-General

Letter transmitting the Report of the OECD Investment Committee to G7 Finance Ministers.



# SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

## Report by the OECD Investment Committee

In recent years major changes in the environment for national security and the international economy have caused a number of OECD and other governments to reassess their investment policies. One important element in the changing global economy is the increasing prominence of Sovereign Wealth Funds (SWFs) from a wide range of home countries.

### *The mandate to the OECD*

Since its creation, the OECD has been a strong advocate of free capital movements and their long term benefits. The OECD has been the primary international forum for policy analysis and development of guidance on good practices for investment policy. This guidance sometimes takes the form of authoritative, even legally-binding, government-backed investment instruments.

Because of this, the OECD has been asked by the G7 Finance Ministers and the other OECD members to develop guidance for recipient countries' policies toward investments from SWFs. Follow-up on this mandate has been undertaken as part of the Investment Committee's project on "Freedom of Investment, National Security and 'Strategic' Industries" and has benefited from the participation of non-OECD countries. The project is independent from, but complements efforts underway in the International Monetary Fund (IMF) to develop voluntary best practices for SWFs.

This note explains the general context for this work, reports on its preliminary findings and describes the next steps.

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### *SWFs bring benefits to both home and host countries*

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The rapidly growing number and size of SWFs reflect the growth in foreign exchange assets that accrue mainly via revenues from commodity markets or intervention in the foreign exchange market. Budget revenues are also important in some cases. SWFs represent efforts by owners of these assets to manage them in a more proactive and sophisticated way.

SWFs have much to offer. SWFs' recent injections of capital into several OECD financial institutions were stabilising because they came at a critical time when risk-taking capital was scarce and market sentiment was pessimistic. They help to recycle savings internationally and generally have a good track record as long-term investors. They contribute to the economic development of their home countries; for example, they help to shield their economies from volatility in commodity markets, improve the risk-return profile of government-controlled portfolios and may boost financial and fiscal management capacities. In recipient countries, SWFs can also bring the benefits normally associated with foreign investment such as stimulating business activity and creating jobs. As one of the world's main proponents of an open investment system, the OECD welcomes these benefits for home and host countries.

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### *Existing OECD principles call for fair treatment of SWFs*

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But, as is often the case, when new actors emerge on the international financial scene, the players need to become better acquainted. The growing role of SWFs raises issues regarding the smooth functioning of financial markets and they raise investment policy questions, including legitimate concerns in recipient

This report was adopted by the OECD Investment Committee on 4 April 2008. The non-member countries participating in the "Freedom of Investment" project include: the 10 non member adherents to the OECD Declaration on International Investment and Multinational Enterprises (Argentina, Brazil, Chile, Egypt, Estonia, Israel, Latvia, Lithuania, Romania, and Slovenia). In addition, Russia attended all of the discussions and other countries (China, India, Indonesia and South Africa) attended one or more. On 31 March 2008, the OECD and City of London co-hosted an event which gave sovereign wealth funds an opportunity to provide in-puts to OECD work.



countries about protecting national security. Inter-governmental dialogue will increase understanding and contribute to well-informed policy development, and thereby help to avoid protectionist responses which undermine economic growth and development. It will enable SWFs and recipient countries to design and implement policies upon which mutual confidence and trust can grow.

The OECD's existing investment instruments already contain fundamental principles for recipient country policies needed for the required guidance. Through

their adherence to the OECD investment instruments, OECD and other adhering governments have committed to the principles of transparency, non-discrimination and liberalisation. These principles are summarised in Box 1. These instruments: 1) express a common understanding of fair treatment of foreign investors, including SWFs; 2) commit adhering governments to build this fair treatment into their investment policies; and 3) provide for "peer review" of adhering governments' observance of these commitments.

### **Box 1. The OECD acquis – established investment policy principles**

The key OECD investment instruments are the OECD Code of Liberalisation of Capital Movements, adopted in 1961, and the OECD Declaration on International Investment and Multinational Enterprises of 1976, as revised in 2000. They have procedures for notification and multilateral surveillance under the broad oversight of the OECD's governing Council to ensure their observance. The instruments embody the following principles:

- *Non discrimination.* Foreign investors are to be treated not less favourably than domestic investors in like situations. While the OECD instruments protect directly the investment freedoms of those SWFs established in OECD member countries, they also commit members to using their best endeavours to extend the benefits of liberalisation to all members of the International Monetary Fund. Experience has shown that, in practice, OECD governments nearly always adopt liberalisation measures without discriminating against non-OECD countries -- investors from non-member countries reap the same benefits of free market access as OECD residents. Outright discrimination against non-OECD based investors would be a major departure from OECD tradition.
- *Transparency.* Information on restrictions on foreign investment should be comprehensive and accessible to everyone.
- *Progressive liberalisation.* Members commit to the gradual elimination of restrictions on capital movements across their countries.
- *"Standstill".* Members commit to not introducing new restrictions.
- *Unilateral liberalisation.* Members also commit to allowing all other members to benefit from the liberalisation measures they take and not to condition them on liberalisation measures taken by other countries. Avoidance of reciprocity is an important OECD policy tradition. The OECD instruments are based on the philosophy that liberalisation is beneficial to all, especially the country which undertakes the liberalisation.



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### ***National security is a legitimate concern but should not be a cover for protectionist policies***

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The OECD investment instruments recognize the right of member countries to take actions they consider necessary to protect national security (Article 3 on Public Order and Security of the OECD Codes of Liberalisation of Capital Movements and Current Invisible Transactions).

Investments controlled by foreign governments, such as those by SWFs, can raise concerns based on uncertainty regarding the objectives of the investor and whether they are commercially based or driven by political or foreign policy considerations. They can raise concerns with respect to foreign government control or access to defence related technologies -- for example, that such investments could provide a channel for the acquisition of dual-use technologies for military purposes by the acquiring country or for denying technology or other assets critical for national defence to the recipient government itself, or for aiding the intelligence capabilities of a foreign country that is hostile to the host country.

However, OECD members have agreed that the national security clause of the OECD investment instruments should be applied with restraint and should not be a general escape clause from their commitments to open investment policies.

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### ***Security-related investment safeguards should be made as open as possible***

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Since 2006, OECD and non-OECD countries have been discussing appropriate means to address legitimate national security concerns while preserving and extending the open international investment system. These discussions have taken place in the context of the OECD Investment Committee's project on "Freedom of Investment, National Security and 'Strategic Industries'" through a series of discussions held in

conjunction with regular meetings of the Investment Committee. Best practices for recipient country policies toward SWFs are being taken up in the context of this broader discussion.

Surveys of the policies of participating countries and related analyses and discussions have revealed that most countries have one or more investment measures designed to safeguard national security. However, few presently have explicit policies regarding foreign government-controlled investors, such as SWFs. Four of the thirty members have laws restricting foreign government-controlled investors. One includes foreign government control as a public interest test for merger reviews under its competition law. Two explicitly mention such control as a factor to consider in their investment review processes. Several others have investment review processes that, because of their broad mandates, could include foreign government control as a factor, even though it is not explicitly identified.

Participants in the project have agreed on a number of key principles that should guide governments in the design and implementation of measures intended to address national security concerns in the context of foreign investment. These are transparency and predictability, proportionality and accountability. Participants consider that these principles are equally relevant to addressing national security concerns that arise in the context of investment from SWFs. Box 2 describes these principles and provides preliminary policy guidance based on the discussions to date.

The project includes a process of regular peer monitoring within which countries report measures in place or under consideration and receive feedback from their peers in light of the principles of transparency/predictability, proportionality and accountability and of OECD members' commitments under the OECD investment instruments. The process has revealed that six OECD countries took new measures and that these measures were designed to codify or clarify existing laws. As part of its on-going work, the Committee will continue to monitor developments in this regard.



## Box 2. Investment policy guidance from the freedom of investment project

Participants have agreed on the following guidance for investment policy measures designed to safeguard national security:

*Non-discrimination* – Governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security.

*Transparency/predictability* – while it is in investors' and governments' interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes.

- *Codification and publication.* Primary and subordinate laws should be codified and made available to the public in a convenient form (e.g. in a public register; on internet). In particular, evaluation criteria used in reviews should be made available to the public.
- *Prior notification.* Governments should take steps to notify interested parties about plans to change investment policies.
- *Consultation.* Governments should seek the views of interested parties when they are considering changing investment policies.
- *Procedural fairness and predictability.* Strict time limits should be applied to review procedures for foreign investments. Commercially-sensitive information provided by the investor should be protected. Where possible, rules providing for approval of transactions if action is not taken to restrict or condition a transaction within a specified time frame should be considered.
- *Disclosure of investment policy actions* is the first step in assuring accountability. Governments should ensure that they adequately disclose investment policy actions (e.g. through press releases, annual reports or reports to Parliament), while also protecting commercially-sensitive and classified information.

*Regulatory proportionality.* Restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern.

- *Essential security concerns are self-judging.* OECD investment instruments recognize that each country has a right to determine what is necessary to protect its national security. This determination should be made using risk assessment techniques that are rigorous and that reflect the country's circumstances, institutions and resources. The relationship between investment restrictions and the national security risks identified should be clear.
- *Narrow focus.* Investment restrictions should be narrowly focused on concerns related to national security.
- *Appropriate expertise.* Security-related investment measures should be designed so that they benefit from adequate national security expertise as well as expertise necessary to weigh the implications of actions with respect to the benefits of open investment policies and the impact of restrictions.
- *Tailored responses.* If used at all, restrictive investment measures should be tailored to the specific risks posed by specific investment proposals. This would include providing for policy measures (*especially* risk mitigation agreements) that address security concerns, but fall short of blocking investments.
- *Last resort.* Restrictive investment measures should be used, if at all, as a last resort when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.

*Accountability* – procedures for parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that decisions to block an investment should be taken at high government levels should be considered to ensure accountability of the *implementing* authorities. Discussions of accountability under the "Freedom of Investment" project will take place in late 2008.



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## ***Investors and home countries can ease concerns through transparency***

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Although the OECD work focuses on host country policies, observance by SWFs of high standards of transparency, risk management, disclosure and accountability can affect the political and policy environment in which recipient countries act. In particular, observance of high standards by investors should positively influence how recipient countries implement their OECD obligations and OECD's policy recommendations when they design and implement policies to address national security concerns while maintaining their commitment to open markets. The availability of adequate and timely information from SWFs, including their investment goals, facilitates this objective. In addition to contributing to greater confidence by recipient governments, observance of high standards of governance by such investors will also enhance their financial management and, more generally, their effectiveness in fulfilling their fiduciary responsibilities to their owners and shareholders and the expectations of other stakeholders.

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### ***Next steps***

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The OECD also supports the work underway at the IMF on best practices for sovereign wealth funds, calls attention to OECD's voluntary standards on corporate governance and good business conduct, and notes their relevance to work under way at the IMF. These include the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the OECD Guidelines for Multinational Enterprises and OECD pension fund-related guidelines. The OECD looks forward to the outcome of the IMF's work and may consider the results in weighing any proposals made for future work in this area at OECD.

OECD will continue addressing this issue as part of the "Freedom of Investment" project in order to deepen consideration of how governments can maintain their long-standing commitment to open international investment policies -- including for SWFs -- while also protecting essential security interests.

The work programme will include further clarification of best practices regarding the implementation of the three guiding principles, especially "accountability", and any additional work which may seem appropriate in light of the results of the IMF's work.

The resulting framework will foster mutually-beneficial situations where SWFs enjoy fair treatment in recipient country markets and recipient countries can confidently resist pressures for protectionist responses. To this end, the spirit of cooperation that has characterised FOI discussions to date will continue through consultation and dialogue between home and recipient countries and between the IMF and the OECD.

Discussions under the Freedom of Investment project, which take place three times a year, will include a special session on government-controlled investors. Reports summarising the discussions held under the project will continue to be published. A final report on the Freedom of Investment project -- bringing together all of the findings of the discussions -- will be completed in mid-2009.

The resulting policy guidance will take the form of a menu of best practices which are consistent with existing OECD instruments and with the principles of transparency and predictability, proportionality and accountability. Its recommendations may also contain suggestions for appropriate revisions/clarifications to existing OECD instruments. ■



## FURTHER READING

The following material is available on the OECD website at [www.oecd.org/daf/investment/foi](http://www.oecd.org/daf/investment/foi), unless specified otherwise.

Freedom of Investment, National Security and “Strategic” Industries: Progress Report by the Investment Committee, April 2008

OECD Roundtable VI on *Freedom of Investment, National Security and “Strategic” Industries*, 13 December 2007

*Tour d'horizon* of recent developments, OECD Official Use documents (October 2007, December 2007 and March 2008)

Protection of ‘critical infrastructure’ and role of investment policies relating to national security, May 2008

Transparency and predictability for investment policies addressing essential security interests: A survey of practices, April 2008

Proportionality of measures: A survey of practices, May 2008

Competition, International Investment and Energy Security, April 2008

Consultations on Freedom of Investment, National Security and “Strategic” Industries: Submissions by BIAC [www.biac.org](http://www.biac.org) and TUAC [www.tuac.org](http://www.tuac.org)

Identification of Ultimate Beneficial Ownership and Control of a Cross-Border Direct Investor, *International Investment Perspectives, OECD, 2008 (forthcoming)*

Freedom of Investment, National Security and “Strategic” Industries: 2007 Interim Report by the Investment Committee, *International Investment Perspectives, OECD, 2007*

Economic and other impacts of foreign corporate takeovers in OECD countries, *International Investment Perspectives, OECD, 2007*

Essential Security Interests under International Investment Law, *International Investment Perspectives, OECD, 2007*