Sovereign Wealth Funds
And National Security

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Opening Survey for the Audience

How many of you think that Sovereign Wealth Funds:

- Are good for the world economy?
- Invest exclusively for financial gain?
- Invest for political reasons?
- Threaten national security?
- Are already subject to adequate regulatory scrutiny, including with respect to national security?
- Warrant closer regulatory oversight?
How Much Are SWFs Investing?

Sovereign Wealth Fund Investment Activity

Deal Volume ($Bn)

<table>
<thead>
<tr>
<th>Year</th>
<th>Deal Volume ($Bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>11.4</td>
</tr>
<tr>
<td>1998</td>
<td>11.0</td>
</tr>
<tr>
<td>1999</td>
<td>6.8</td>
</tr>
<tr>
<td>2000</td>
<td>9.4</td>
</tr>
<tr>
<td>2001</td>
<td>13.0</td>
</tr>
<tr>
<td>2002</td>
<td>7.6</td>
</tr>
<tr>
<td>2003</td>
<td>5.6</td>
</tr>
<tr>
<td>2004</td>
<td>7.1</td>
</tr>
<tr>
<td>2005</td>
<td>16.8</td>
</tr>
<tr>
<td>2006</td>
<td>44.2</td>
</tr>
<tr>
<td>2007</td>
<td>69.8</td>
</tr>
</tbody>
</table>

# of Deals

<table>
<thead>
<tr>
<th>Year</th>
<th># of Deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>11.5</td>
</tr>
<tr>
<td>2005</td>
<td>16.8</td>
</tr>
<tr>
<td>2006</td>
<td>44.2</td>
</tr>
<tr>
<td>2007</td>
<td>69.8</td>
</tr>
</tbody>
</table>

Sources: World Economic Forum, Thomson Financial
How Does This Compare to Other Strategic Investors?

Breakdown of Global M&A Activity ($Bn)

- Sovereign Wealth Funds
- Private Equity
- Corporate

1.6% of Total M&A Volume

Sources: World Economic Forum, Thomson Financial
### What Kinds of Investments do SWFs Typically Make?

#### Selected SWF Investments in 2007

<table>
<thead>
<tr>
<th>Target</th>
<th>Size ($MM)</th>
<th>% Stake</th>
</tr>
</thead>
<tbody>
<tr>
<td>UBS</td>
<td>9,750</td>
<td>9.0%</td>
</tr>
<tr>
<td>Citigroup</td>
<td>7,500</td>
<td>4.9%</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>5,000</td>
<td>9.9%</td>
</tr>
<tr>
<td>Blackstone</td>
<td>3,000</td>
<td>10.0%</td>
</tr>
<tr>
<td>Barclays Bank</td>
<td>2,970</td>
<td>3.1%</td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>1,416</td>
<td>3.8%</td>
</tr>
<tr>
<td>Carlyle Group</td>
<td>1,350</td>
<td>7.5%</td>
</tr>
<tr>
<td>London Stock Exchange</td>
<td>1,274</td>
<td>20.0%</td>
</tr>
<tr>
<td>Och-Ziff</td>
<td>1,260</td>
<td>9.9%</td>
</tr>
<tr>
<td>EADS</td>
<td>833</td>
<td>3.1%</td>
</tr>
<tr>
<td>Advanced Micro Devices</td>
<td>622</td>
<td>8.1%</td>
</tr>
<tr>
<td>Sony</td>
<td>500</td>
<td>~2%</td>
</tr>
</tbody>
</table>

#### SWF Investments 2002-2007

- **Control**: 23.5%
- **Non-Control**: 76.5%

**Source**: Dealogic

**Note**: 1. Excludes investments in domestic markets  
2. Investment stakes of 50% or more
Why the controversy?

- Rapid growth in number and size of SWFs
- Sovereign Wealth Funds and State Owned Enterprises are making higher profile investments
- Concentration in the developing world
  - Large SWFs are controlled by China, Russia, and Middle Eastern countries
- Outward FDI from developing countries grew 5x from 2003 - 2006
  - From 2000-2006, China outward FDI is up 6.9x; Russia outward FDI is up 5.9x; and UAE outward FDI has increased 37x
- Developed and developing countries are broadening definitions of national security
  - Infrastructure, energy, and technology are now regarded as sensitive sectors
Public Opinion Turning More Negative

- In a recent poll in the US, only 1 in 4 respondents felt that investments made by foreign governments had a positive effect on the US economy
- More than half believed there was a negative effect on national security
- 68% said that these investments give foreign governments too much power in the marketplace
- Yet, only 6% had read anything recently about sovereign wealth funds

Source: Public Strategies, Inc
How are SWF Investments Currently Scrutinized?

- In many countries, SWF investments are reviewed for national security or national interest implications
  - Australia, Canada recently clarified how SWF investments will be reviewed
  - China, Russia, US, France and other major countries have adopted tougher laws or regulations

- In many countries, SWF investments are subject to an elevated level of scrutiny due to concerns about government ownership
  - New US law requires either extended, second stage review or approval by Deputy Minister-level officials

- SWF investments are governed by myriad other domestic laws in each jurisdiction
How has the US regulatory environment changed?

- The number of CFIUS reviews conducted in the United States has increased dramatically
- Growth accelerated after DPW controversy, not 9/11

Frequency of CFIUS Reviews, 2001-2007

- 2001: 55
- 2002: 43
- 2003: 41
- 2004: 53
- 2005: 65
- 2006: 113
- 2007: 147

March 2006: Dubai Ports Controversy
How has the US regulatory environment changed? (cont’d)

- More in-depth CFIUS reviews
  - There were more second-stage investigations in 2006-2007 than in the previous 15 years combined
- Instances of “mitigation agreements,” in which CFIUS imposes conditions in exchange for approving a transaction, have also risen dramatically
  - There were 27 in 2006-2007, versus 13 in the previous three years
How has the Global Regulatory Environment Changed?

- Many countries already have investment review mechanisms covering either national security or public interest concerns.
- *In the last two years alone,* more than a dozen countries representing >40% of inward FDI have adopted or are debating new national security-related review laws or regulations.

- Australia
- Canada
- China
- France
- Germany
- Iceland
- India
- Israel
- Japan
- Korea
- Mexico
- New Zealand
- Russia
- United Kingdom
- United States
Is The Regulatory Environment Adequate Around the World?

- Over the past 50 years, no SWF investment that I am aware of has compromised national security in any country.
- Review processes have been strengthened in many countries.
- Receiving countries are “sovereign” with respect to laws in their own country.
How Should National Security Review Mechanisms be Structured?

- Narrowly tailored
  - The investment-review law should be narrowly tailored and focused on national security and not on economic factors

- Predictable and timely
  - The investment-review process should provide predictability to transaction parties by ensuring that reviews will be conducted within a definitive timeframe

- Confidential
  - The investment-review process should ensure confidentiality to the transaction parties

- Precisely defined
  - Where countries use sector-based lists to determine transactions requiring investment reviews, the lists should be drafted as narrowly as possible
A Consensus Is Building in Favor of A Voluntary Code of Conduct for SWFs

- Elements of a voluntary code of conduct:
  - Formal declaration that investment decisions should be based solely on commercial grounds, rather than to advance geopolitical goals of the controlling government
  - Disclosure of investments, investment allocation
  - Discussion of decision-making process for investments

- Many SWFs are responding positively
  - Abu Dhabi and Singapore have both agreed in principle to a code of conduct

- The IMF is drafting a code of conduct
Should There Be A Code of Conduct for Recipient Countries?

- Foreign direct investment should be welcomed
- National security regimes should be predictable, narrowly tailored
- Investments should not be politicized
- Governments should not intervene in the market to create national champions or protect them from foreign ownership unless there is a true national security rationale
Conclusion

- Sovereign Wealth Funds should not be feared
  - Negative rhetoric or political pressure could itself chill investment

- Current concerns are rooted in hypotheticals, which are contradicted by SWFs’ 50-year track record of investing responsibly and for economic reasons

- Regulatory structures around the world are adequate to protect any threats
Final Question for the Audience

- Which is the greater risk:
  SWFs making investments for political reasons, or receiving countries blocking SWF investments for political reasons?
Sovereign Wealth Funds

David Marchick