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

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

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Abstract

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Sovereign Wealth Funds ("SWFs") create special problems for regulators concerned with protecting investors in the United States. Namely they are opaque investment vehicles investing the foreign reserves of another nation. This differentiates them from other opaque investment vehicles like hedge funds because while a hedge fund can be counted on to try to maximize returns (thanks to the discipline of the market), the same cannot necessarily be said of SWFs. A regulator seeking to get a more transparent understanding of a SWF's motives needs mechanisms to regulate SWF activities. The current legal tools provided by international agreements that are available to U.S. regulators have ineffective regulatory provisions. Other methods of applying indirect pressure through the Basel II Accord or the IMF Articles of Agreement are equally ineffective. These agreements could offer a solution if discrete changes are made to them.
Advisor: Professor V. Gerard Comizio
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I. Introduction

The failure of a foreign state-owned company’s attempted purchase of a U.S. port management company stands in sharp contrast to Sovereign Wealth Funds (“SWFs”) ability to invest in the United States following the 2007 subprime mortgage crisis.¹ SWFs invested in the U.S. financial sector, which is arguably a more sensitive sector than the management of shipping containers.² U.S. Securities and Exchange Commission (“SEC”)

¹ See Edward M. Graham & David M. Marchick, U.S. National Security and Foreign Direct Investment 128-36 (Institute for International Economics 2006) (describing the politicization of the Committee on Foreign Investment in the United States (“CFIUS”) review for the proposed title transfer of Peninsular and Oriental Steam Navigation Company to Dubai Ports World, which is owned by the United Arab Emirates). 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. Id.
² See Robin Sindel, 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 management of Citigroup).
Chairman Christopher Cox stated that the rise of SWFs poses a challenge to regulators.\textsuperscript{3} Solving this regulatory challenge is not easy even with the existing international agreements signed or implemented by the United States. The main challenge of regulating SWFs is that they are investors and U.S. regulators generally do not regulate investors.\textsuperscript{4} The rise of SWFs raises questions about how to regulate them, but the extant literature does not consider the legal issues surrounding regulation through international agreements.

In Part II, this comment will define SWFs, discuss the current state of SWF regulation by U.S. regulators, and introduce the availability of defenses or jurisdictional bars


\textsuperscript{4} See discussion infra Part II.B (discussing the current approach to the regulation of SWFs and the exceptions to a lack of regulation of investor behavior).
available to a SWFs in the U.S. judicial system. Additionally, Part II will examine the various international agreements that could potentially affect the U.S. regulation of SWFs. In Part III, this comment determines the infeasibility of sovereign action jurisdictional bars in U.S. courts. Next, it 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 force effective disclosures from SWFs. Then, this comment examines the potential of indirect regulation

5 See discussion infra Part II.C (discussing the availability of defenses in U.S. courts to prevent liability from securities laws and the likelihood of those defenses not working).

6 See discussion infra Part II.D (describing two agreements that deal specifically with investment, and two agreements that regulate the international financial system: one through a soft law approach and the other through a formal treaty).

7 See discussion infra Part III.B (stating that these defenses are not viable options for a SWF and would not prevent a U.S. regulator from going after a SWF).

8 See discussion infra Part III.C (stating that these instruments may be a nonfactor in the case of the IOSCO MOU and create an obstacle in the case of U.S. Model BIT).
through financial intermediaries under the Basel II Accord and finds it offers little relief. Finally, this comment finds little role for the International Monetary Fund ("IMF") Articles of Agreement in regulating SWFs.

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

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9 See discussion infra Part III.D (arguing that the deference to banks in the credit assessment of public sector entities ("PSEs") prevents regulators from indirectly applying pressure on SWFs through intermediaries).

10 See discussion infra Part III.E (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. Appleyard, Alfred J. Field, Jr. & Steven L. Cobb, International Economics 725 (5th ed., McGraw-Hill 2006) (revealing that some refer to the SDR as "paper gold" because the IMF created the reserve asset "out of thin air"). The IMF utilizes a basket of currencies to determine the value of the SDR. Id.
Articles of Agreement. These recommendations account for the policy context in which they must operate. In closing this comment concludes that international agreements provide little support for potential U.S. regulation of SWFs.

II. Background

SWFs pose a unique challenge to U.S. financial regulators who are dependent upon foreign regulators in a globalized financial world because U.S. regulators need foreign regulators to provide information about foreign violators of U.S. securities laws. Success in the modern investment world also requires investors to adopt new finance techniques. These two trends influence any understanding of SWF regulation.

11 See discussion infra Part IV (offering specific recommendations to remedy the problems outlined in Part III of this comment).

12 See generally International Organization of Securities Commissions, Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, May 2002 [hereinafter IOSCO MOU] (revealing the need for international cooperation for the enforcement of securities laws).

13 See infra note 37 (explaining the logic behind modern investment techniques).
SWFs raise fundamental questions about whether the United States is willing to regulate investor activity and how that regulation would hold up under international agreements.\textsuperscript{14} In defense of potential regulatory proceedings in a U.S. court, SWFs may raise jurisdictional bars related to sovereign actions.\textsuperscript{15} It is important to consider the context in which SWFs operate. The United States entered into numerous bilateral agreements.


agreements to promote and protect investment.\textsuperscript{16} It entered into a multilateral information sharing agreement to better prosecute trans-border securities law violators.\textsuperscript{17} Additionally, the United States entered into agreements to protect the stability of the international financial system.\textsuperscript{18} Each of these helps illuminate the legal context surrounding the regulation of SWFs.

\textsuperscript{16} See Appendix C.
\textsuperscript{17} IOSCO MOU.
A. Introduction to Sovereign Wealth Funds – Old Players with New Names and Modern Techniques

SWFs control vast sums of capital, which they are currently investing in the United States, and they are reluctant to disclose information about their investment activities.\(^{19}\) The rapid growth in both number of SWFs and their cumulative wealth under management is leading some to call for their regulation.\(^{20}\) The risks SWFs pose are different than those posed by other financial market participants such as hedge funds or institutional investors like pension funds, which have different mandates and motivations for investing.\(^{21}\)


\(^{20}\) See generally Cox, supra note 3 (calling for recognition of the special challenges to the U.S. regulatory structure presented by SWFs).

\(^{21}\) See Eizenstat & Larson, supra note 19 (noting that pension funds invest on behalf of pensioners while SWFs may invest to control strategic resources or bolster national companies).
1. General Overview of Sovereign Wealth Funds

SWFs are not a new phenomenon,\textsuperscript{22} though they are garnering more attention recently.\textsuperscript{23} They are government owned investment

\textsuperscript{22} 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 setup Caisse des Dépots), with The World’s Most Expensive Club, Economist, May 24, 2007, http://economist.com/finance/displaystory.cfm?story_id=9230598 (stating that the origins of SWFs probably began inadvertently in 1956 with the Gilbert Islands and the British administration of Micronesia). The government imposed a levy on phosphate exports and the money set aside from the levy became the basis of the Kiribati Revenue Equalisation [sic] Reserve Fund, which is now nine times the country’s GDP. Id.

\textsuperscript{23} See 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 (estimating that SWFs currently account for about $3 trillion of the world’s wealth). 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. Id.
vehicles that invest a country’s reserve assets.\textsuperscript{24} More

\textbf{Compare id.} (arriving at a $10 trillion estimate for assets controlled by SWFs in 2012), with Cox, supra note 3 (proposing SWFs could control $12 trillion by 2015); see also Johnson, supra note 23 (arguing the divergence in figures is not surprising as there is a “dearth of information” with respect to SWFs); see generally Bob Davis, \textit{How Trade Talks Could Tame Sovereign-Wealth Funds}, \textit{Wall St. J.}, Oct. 29, 2007, at A2 (analyzing the possibility of making SWF regulation a new topic for global trade talks); Stuart E. Eizenstat & Alan Larson, supra note 19 (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).

\textsuperscript{24} \textit{Cf. Appleyard et al.}, supra note 10, 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. \textit{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. \textit{Id.} The revenue from exports brings more money into the country than
specifically, they invest excess reserves in assets denominated leaves the country in terms of spending on imports. In this example, if this trade imbalance persists, then the net exporting country builds up surplus dollars. The Chinese state builds up these assets because it exchanges yuan, which is the Chinese currency, with citizens who receive dollars in exchange for the goods they exported.

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. See Johnson, supra note 13 (stating that “extra” reserves are those in excess of what a country feels are necessary for “immediate purposes”); see also 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 interest rates that are too high). The U.S. monetary base is the sum of “total bank deposits plus notes and coins in circulation.” at 267. A country’s monetary base is the combination of money in circulation and demand deposits held by the central bank for financial institutions. at 267-69.

Countries define their monetary bases differently, thus, their
in another country’s currency.\textsuperscript{26} The goal of SWFs is to invest excess reserves over a long-term time horizon while maximizing investment returns.\textsuperscript{27} Additionally, SWFs differ from institutional investors like pension funds in that they generally have no explicit liabilities.\textsuperscript{28} By way of example, a definitions of excess reserves are not always the same. Id. at 267.

\textsuperscript{26} See Hildebrand, supra note 22 (laying out the general approach of SWF investment choices, which tends toward foreign assets).

\textsuperscript{27} See Belinda Cao, China’s $200 Billion Sovereign Fund Begins Operations (Update 1), \textit{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).

\textsuperscript{28} See Hildebrand, supra note 22 (giving the best available definition of a SWF because by not having to make specific payments, such as pension funds that pay pensioners at a delineated time, allows SWFs to act in a manner unfamiliar to regulators); 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 SWFs have no explicit
liabilities may also allow them to resist pulling out of markets when there are economic downturns and allow them to help stabilize the international financial system). Truman questions what role SWFs will ultimately play in the international financial system. Id. But see Martin A. Weiss, CRS Report for Congress, Sovereign Wealth Funds: Background and Policy Issues for Congress 6 (2008) (noting that the Chinese SWF must service a debt load of $40 million per day).

29 See Hildebrand, supra note 22, at 2 (arguing that this is a critical difference between SWFs and pension funds).
A SWF is an entity separate\textsuperscript{30} from a country’s central bank.\textsuperscript{31} The primary objective of the SWF is to maximize the

\textsuperscript{30} 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 (Kluwer Acad. Pub. 2001) (questioning the ultimate autonomy of a 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). However, it remains to be seen the autonomy of a SWF in a non-democratic society as the causal link between the institution and the populace is more tenuous than in a democratic society. Id.

\textsuperscript{31} See Ewart S. Williams, Governor, Central Bank of Trinidad and Tobago, Feature Address to the South Trinidad Chamber of Commerce Annual General Meeting: 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
risk/return equation (“$r/r$ equation”). A central bank’s primary objective is to eliminate risk and worry little about the return

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 25, 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.

32 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
on the investment.\textsuperscript{33} In addition, because SWFs have a longer investment time horizon, they can diversify away from short-term

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 faces investors, which is whether they want more security in an investment with a lower rate of return, or if they want a higher return and less security. \textit{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. \textit{Id.}

\textsuperscript{33} \textit{See Williams, supra} note 31, at 3-4 (stating that nature or source of a country’s excess reserves may dictate how a SWF maximizes the r/r equation). The Trinidad and Tobago SWF cannot invest in assets directly related to oil and gas because this is the source of Trinidad and Tobago’s excess reserves. \textit{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. \textit{Id.} \textit{See also Hannesson, supra} note 30, at 40-43 (arguing that before a government sets up a SWF it must make a basic choice between investing in infrastructure, health, and education, or choosing to invest “in
liquid asset classes and invest in long-term illiquid asset classes.\textsuperscript{34}

\begin{quote}
projects that are profitable on the basis of conventional market criteria”). Essentially there is an opportunity cost to setting up these funds whereby a country seeks to provide funds as opposed to other investments for future generations, which allows those future generations to spend the money in a manner that they see fit. \textit{Id. Cf.} Keith Bradsher, \textit{China Faces Backlash at Home Over Blackstone investment}, \textit{Int’l Herald Trib.}, Aug. 2, 2007, http://www.iht.com/articles/2007/08/02/opinion/backlash.php (quoting one anonymous Chinese blogger who admonishes the government that “[t]he foreign reserves are the product of the sweat and blood of the people of China, please invest them with more care!”).
\end{quote}

\textsuperscript{34} 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 \textit{BIS Review}, Nov. 3, 2007 available at http://www.bis.org/review/r071009b.pdf (explaining that SWFs are seeking a return higher than that necessary to preserve the real value of the reserves, which is a central bank’s goal for the
2. **Fiduciary Duty and Modern Financial Techniques**

Allowing ever-increasing reserves to reside in low-yielding liquid assets may not comport with a central banker’s fiduciary duty to manage the reserves of his or her country in the country’s best interest.\(^ {35} \) Therefore, the government sets up a separate entity with different reserve management objectives, yet the fiduciary duty to manage the reserves in the best

reserves it holds to cover its monetary base), and Bradsher, supra note 33 (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 31 (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.

\(^ {35} \) See The World’s Most Expensive Club, supra note 22 (showing the question becomes more pertinent as reserves mushroom because of the opportunity cost associated with unspent funds).
interests of the country remains.  

In order to act in accordance with its fiduciary duty while maximizing the r/r equation, SWFs would engage in many of the modern finance techniques that allow them to hedge some of their risk. SWFs will incur some unique 

\[36\] See Hannesson, supra note 30, at 42-43 (arguing that there is an opportunity cost to creating a 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 33 (noting that the public may take a different view over how to invest a country’s excess reserves).

\[37\] 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 the investors manage their beta risk according to their individual r/r equation, or asset allocation strategy. Id. More recent 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 utilize modern finance techniques and thus, 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 used in investing today, which implies a wide dissemination of modern finance techniques). Additionally, 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 25, at 174 (defining a future as 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. Id. at 295.
risks that accompany investments in foreign denominated assets.\textsuperscript{38} A SWF will need to enter into various contracts to hedge against the risk of currency devaluations, interest rate fluctuations, or simply using equity derivatives to hedge a position,\textsuperscript{39} which will lead the SWF to become a “counterparty” to an investment contract because it cannot hedge its positions alone.\textsuperscript{40}

\textsuperscript{38} See Williams, supra note 31 (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 a SWF may use to mitigate the myriad risks inherent in foreign asset investment).

\textsuperscript{39} See Loss & Seligman, supra note 37, 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).

\textsuperscript{40} See A Dictionary of Finance and Banking, supra note 25, at 95 (defining a counterparty as a party to a contract and counterparty risk as the risk that counterparties will fail to honor their obligations under the contract); see also Norman
B. Current U.S. Regulatory Approach Toward SWFs

The current approach to the regulation of SWFs is analogous to that of hedge funds, which is not to regulate them directly,

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 the effect of the two is the same at least in the short term, which is the party to the transaction is not paid when it is time for settlement).

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 both short selling and leverage); cf. A Dictionary of Finance and Banking, supra note 25, at 236 (articulating leverage as 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
but to “watch carefully over the regulated intermediaries that lend to them.” However, SWFs generally would not need to borrow large sums of money. Their very existence suggests that the countries which form them have excess cash.

The SEC is essentially regulating an investor if they attempt to regulate SWFs, but this runs contrary to the ethos of the disclosure system created by the Securities Act of 1933 (“1933 Act”) and the Securities Exchange Act of 1934 (“1934 Act”).

\[\text{pay for a derivative position thereby using a small amount of assets to create a highly leveraged position).}\]

\(42\) See Johnson, supra note 13 (stating that these regulated intermediaries are commercial and investment banks).

\(43\) See Hedge Fund Report, supra note 41, at 1 (giving a working definition of hedge funds and noting their prevalent use of leverage to boost overall returns to capital); see also supra note 23 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 a SWF to 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. \textit{Cf. id}.\]

Act”). The SEC does regulate certain activities by investors with insider trading as the principal activity. The most

45 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).

46 See 15 U.S.C. § 78j (prohibiting the use of manipulative and deceptive devices by “any person”). The inclusion of 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 37, 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
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. Additionally, information disclosure. Id. at 858. The Property Rights argument views information as corporate property and is especially persuasive for information that the corporation utilized resources to develop it. 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 because they have the potential to undermine public confidence since they may not have profit as their main motive, and they could utilize national intelligence resources to steal a company’s proprietary information to achieve a better return or avoid a loss. Id. at 857, 859.

47 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, 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
an investor may become an issuer\textsuperscript{48} and receive liability exposure\textsuperscript{49} by selling unregistered securities through a company that it controls.\textsuperscript{50} Finally, a beneficial owner, which is defined as a director, officer, or shareholder owning more than ten percent of a §12 company, is open to a number of different arrangements it may have concerning the issuer, which includes puts or calls. Id. § 78m(d)(1)(B)-(D).

\textsuperscript{48} See 15 U.S.C. § 77b(a)(4) (defining issuer as a person who issues any security); see also 15 U.S.C. § 77q (requiring issuers to furnish certain information in their registration statement when issuing securities).

\textsuperscript{49} See 15 U.S.C. § 77k (creating a private right of action for any purchaser of a security accompanied by a false registration statement).

\textsuperscript{50} See Weiss, supra note 28, at 8 (showing the Chinese SWF’s control of various Chinese companies); see also id. at 3 (claiming the Chinese SWF could easily purchase Ford, G.M., Volkswagen, and Honda combined); but 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 suggest the SWF is attempting to limit its liability exposure).
provisions of the 1934 Act that potentially increase a beneficial owner’s liability.\textsuperscript{51}

\textbf{C. Testing the Sovereign Immunity of SWFs}

Before delving into the international framework for regulating SWFs, it is necessary to understand the domestic limitations U.S. courts impose on those seeking to bring a foreign government’s entity within a U.S. court’s jurisdiction. Three doctrines offer SWFs a potential defense to a U.S. regulator’s litigation: sovereign immunity, the act of state doctrine, and international comity.\textsuperscript{52} It is important to understand the domestic hurdles 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.

\textbf{1. Restrictive Theory of Sovereign Immunity}

\textsuperscript{51} 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).

\textsuperscript{52} See Power, \textit{supra} note 15, at 2723-41 (discussing the hurdles to suing a sovereign entity in U.S. courts within the context of sovereign debt defaults).
SEC Chairman Cox states that SWFs are not immune from U.S. jurisdiction when violating securities laws.⁵³ The Foreign Sovereign Immunities Act of 1976 ("FSIA"), codified the

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⁵³ See Cox, supra note 3 (arguing neither the Foreign Sovereign Immunities Act nor international law prevent the SEC from pursuing enforcement action against SWFs). The implication of Cox’s statement seems to be that he believes 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 a SWF controlled by the very government from which the SEC is requesting assistance. Id. The U.S. Supreme Court backs 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 15, at 2729-32 (analyzing the application of the Weltover decision to the sovereign debt crisis and its implication for sovereign immunity claims).
“restrictive theory” of sovereign immunity.\(^5^4\) As opposed to an expansive interpretation of sovereign immunity, the restrictive theory states 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.\(^5^5\)

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

\(^{5^4}\) 28 U.S.C. §§ 1602-1611 (2008); see Power, *supra* note 15 at 2728 (purporting 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).

\(^{5^5}\) 28 U.S.C. § 1602; see Power, *supra* note 15, at 2728 (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 on the United States.”)
state’s official acts performed within its sovereign territory even when a U.S. court otherwise has jurisdiction. Unlike sovereign immunity, the rule is not waivable. In order to qualify as a jurisdictional bar, the act of state doctrine requires that a U.S. court would be “declaring invalid the official act of a foreign sovereign performed within its own territory.”

56 See Power, supra note 15, at 2733-34 (giving the 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).

57 Id. at 2732 (stating that “[t]he most important limitation on the doctrine’s effectiveness [as a sovereign’s defense] 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 a 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.

58 See W.S. Kirkpatrick v. Envlt. 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
3. International Comity

Comity\(^{59}\) is similar to the act of state doctrine in that neither is a rule of law,\(^{60}\) but comity differs in two key respects: 1) there is no territorial limitation for the doctrine 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. \textit{Id.} Additionally, the Court notes that even “modern” conceptions of international comity do not recognize sovereign immunity for commercial transactions. \textit{Id.}

\(^{59}\) \textit{See Black’s Law Dictionary} 114 (3d Pocket ed. 2006) (defining comity as the practice among different nations involving mutual recognition of each other’s actions).

\(^{60}\) \textit{Power, supra} note 15, at 2738; compare \textit{Sportex 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 \textit{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).
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.\textsuperscript{61} 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.\textsuperscript{62} An analysis of comity within the context of sovereign debt defaults demonstrates the limited defensive usefulness of this doctrine to a would-be violator of U.S. law.\textsuperscript{63}

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

The SEC and the United States Trade Representative ("USTR") both seek to protect U.S. investors though they achieve their objectives in different manners. The USTR attempts to prevent foreign government interference in investments by U.S.

\textsuperscript{61} See Power, supra note 15, 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).

\textsuperscript{62} Id. at 2738-39.

\textsuperscript{63} 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, and thus, the defense would fail).
investors.\textsuperscript{64} The SEC protects investors from fraudulent activity by companies operating domestically and abroad.\textsuperscript{65} These agencies recognize the importance of collaborating with other countries to achieve their respective goals.\textsuperscript{66}

1. U.S. Model Bilateral Investment Treaty

Bilateral Investment Treaties ("BITs") originated in the 1960s to provide "a stable international framework for the regulation of foreign direct investment."\textsuperscript{67} BITs are most

\textsuperscript{64}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 [hereinafter Summary] (stating that the BIT program attempts to provide protection to U.S. citizens investing in countries that may lack effective investor protection).

\textsuperscript{65}See generally 15 U.S.C. §§ 78a-nn (creating a disclosure system for regulated companies in the U.S. market).

\textsuperscript{66}See generally IOSCO MOU, supra note 12 (providing a mechanism for the SEC to request information concerning its operations that may affect participants located in other countries).

\textsuperscript{67}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
effective in two key areas: providing for the protection of investments and providing a forum for the resolution of investment disputes.\textsuperscript{68} BITs serve as binding statements of international law that allow parties to seek redress from a third party arbitrator.\textsuperscript{69} 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.\textsuperscript{70} U.S. BITs provide investors with six benefits including the requirement that foreign investments receive the same treatment as domestic investments.\textsuperscript{71}

\begin{itemize}
\item how they serve to protect the individual investor unaccustomed to the risks of investing in foreign markets).
\item See id. at 198 (arguing that the BIT is a key improvement over the previous treaties known as Friendship, Commerce, and Navigation Treaties (“FCNs”), which Adair regards as the “first step in the evolutionary process of the regulation of investment”).
\item See U.S. Model BIT, supra note 14, art. 24 (allowing for submission of investment disputes to an independent arbitrator that adheres to international arbitration rules).
\item Id.
\item See Summary, supra note 64 (explaining the benefits of the BIT program). The other five benefits are: 1) they establish limits
\end{itemize}
2. 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. 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. The signatories to the MOU pledge to exchange information in the areas of:

- The expropriation of investments,
- Foreign exchange rates,
- The imposition of performance requirements, such as local content targets or export quotas,
- Allowance for investors to choose their management,
- And international arbitration for the resolution of investment disputes.

See IOSCO MOU, supra note 12, § 6(a) (emphasizing that parties’ intent to mutually assist one another, but explicitly stating that the provisions are not binding).

investigation of securities and futures trading violations.\textsuperscript{74} The IOSCO MOU serves as an example of regulatory equivalence rather than harmonization because the participants have no obligation to change their securities laws.\textsuperscript{75}

\textbf{E. International Financial System Agreements}

\textsuperscript{74} 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.

\textsuperscript{75} See Jorge E. Vinuales, The International Regulation of Financial Conglomerates: A Case Study of Equivalence as an Approach to Financial Integration, \textit{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 regulatory to determine that an information request does not comply with their 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 48, 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.
Broadly, the international financial system is comprised of central banks and central monetary authorities, and those financial intermediaries that they regulate. 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. The IMF Articles of Agreement provide the means for countries to coordinate their exchange rate policies and to provide information about reserve management. Both of these agreements offer potential avenues for U.S. regulation of SWFs.

1. Basel II Accord

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).

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).

IMF Articles, supra note 18.
The Basel Committee on Banking Supervision ("BCBS") created the Basel II Accord to fashion a more flexible approach to

79 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 25, at 189-90 (stating that the group originally began as a group of lenders for the IMF) and BCBS, History of the Basel Committee and its Membership, Jan. 2007, available at http://www.bis.org/bcbs/history.htm. 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, www.bis.org, available at: http://www.bis.org/stability.htm (describing the breakdown of the committees housed at BIS). The BCBS is not a formal supervisory authority, but rather recommends standards and guidelines in an effort to have those implemented by the individual authorities. Id. See also History, supra note 79 (suggesting that it does not possess any authority is a bit of a
managing banks’ capital adequacy in an effort to ensure “the
safety and soundness of the international banking system while”
not creating any competitive disadvantage for internationally
active banks.\textsuperscript{80} 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.”\textsuperscript{81} Individual members implement the
misstatement since its members do have the authority in many
instances to impose its decisions).

\textsuperscript{80} See generally Basel II Accord (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. \textsuperscript{See also U.S. Final Rule, supra note 18 (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
competitive issues, increase regulatory burden without improving
overall safety and soundness).

\textsuperscript{81} See Joseph J. Norton, An Interim Filling the Gap in
Multilateral, Regional, and Domestic Hard Law Deficiencies
Respecting Financial Services within the Americas, 12 \textit{Law & Bus.
Rev. Am.} 153, 159 (2006) (arguing that the soft law process may
measures included in the Basel II Accord. It 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 set aside enough capital in case these risks materialize. Depending on whom the bank is not work for other financial regulator “standard-setters” like the IOSCO MOU signatories).

BCBS, supra note 79, at 1; see U.S. Final Rule, supra note 518, 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. 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
interacting with, affects how much capital a bank must set aside for a particular transaction, or in other words how big a capital charge a bank must take.  

The key to the First Pillar, or Minimum Capital Requirements, of the Basel II Accord is the credit assessment of the entities with which banks interact. A SWF’s potential classification under the Basel II Accord is as Public Sector Entity (“PSE”). The decision of whether to give the SWF the keys to this approach is disclosure by banks of risks on their balance sheets. Id. at 6.

See id. at 15-47 (outlining the Standardised 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 then the bank sets aside less capital and therefore can finance more deals because it is taking a smaller capital charge. Id.

See 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
same credit assessment as the sovereign, or as a normal commercial entity, is at the bank’s discretion.\textsuperscript{86} SWFs engaging in atypical transactions when compared to the average sovereign borrower, or institutional investor, complicate the decision for banks.\textsuperscript{87}

2. The IMF Articles of Agreement and Disclosure Requirements Concerning Foreign Exchange Reserves

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 since they manage reserve assets. The IMF Articles of Agreement governs IMF operations and it is a non-self-executing treaty in the sense that it does not 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.\textsuperscript{86} Id.\textsuperscript{87} See Hildebrand, supra note 22 (demonstrating that SWFs do not need to raise funds; they need to invest funds).
not create a private right of action.\textsuperscript{88} Rather, it is a horizontal relationship between states.\textsuperscript{89}

The framers of the IMF Articles of Agreement designed them for the post-WWII exchange rate system with the U.S. dollar as

\textsuperscript{88} See Sloss & Jinks, U.S. Chapter, 5 (forthcoming 2008) (manuscript on file with the 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, 473 F.3d at 482–83 (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. \textit{Id.}

\textsuperscript{89} See Sloss & Jinks, supra note 88, at 6 (noting that the other two relationships are “vertical relationships between states and private parties and private transactions between private parties.”). Thus, they continue that it makes sense that treaties predicated on horizontal relationships would be non-self-executing because they do not create private rights of action. \textit{Id.}
the centerpiece of the system. Indeed, the use of the dollar as the centerpiece of the system led in part to the holdings of excess reserves in dollar-denominated assets. It is these assets that SWFs are now investing. 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.

III. Analysis

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90 See Eichengreen, supra note 76, at 93-135 (stating that the British members of the Bretton Woods Conference did not want the dollar to be the centerpiece, but relented in their demands).

91 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-WWII monetary system).

92 See generally IMF Articles, supra note 18 (providing the general obligations of members to coordinate on exchange rate policy and to manage their reserve assets in line with Articles of Agreement).
SWFs create multiple risk points within the U.S. financial system.\textsuperscript{93} Their status as a commercial entity prevents them from raising jurisdictional bars in the U.S. courts.\textsuperscript{94} Current international agreements, however, do not offer an effective means to regulate SWFs.\textsuperscript{95} The IOSCO MOU and the U.S. Model BIT are an ineffective means of potential regulation, and indeed could hinder effective regulation.\textsuperscript{96} Additionally, the parties to these agreements generally do not control SWFs.\textsuperscript{97} 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

\textsuperscript{93} See infra Part III.A (creating a framework to understand how SWFs interact with the U.S. financial system).

\textsuperscript{94} See infra Part III.B (determining the inapplicability of jurisdictional bars for SWFs in U.S. courts).

\textsuperscript{95} See infra Parts III.C-E (examining the potential role of international agreements in U.S. regulation of SWFs).

\textsuperscript{96} See infra Part III.C (analyzing the deficiencies in the U.S. Model BIT and the IOSCO MOU).

\textsuperscript{97} 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).
its implementation. Finally, the IMF Articles of Agreement are ill-equipped to deal with the realities of the post-WWII financial system.

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

A SWF presents 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. These are not necessarily discrete categories, but serve as a useful framework to understand the challenges facing U.S. regulators. Keeping these fluid risk categories in mind,

98 See infra Part III.D (highlighting the challenges to making unilateral changes during implementation of the Basel II Accord by the United States).
99 See infra Part III.E (arguing that the IMF Articles of Agreement are a post-WWII relic).
100 See Weiss, supra note 28, at 8 (noting the Chinese SWF’s investments in U.S. banks and alternative investment managers).
101 See Blackstone Group, L.P., Registration Statement (Form S-1), at 4 (June 11, 2007) (asserting that the Chinese SWF will be restricted from purchasing future equity that could cause it to
the opacity of SWFs leads to concerns about the motivation and purpose of their investments. Politicians and investors alike may question whether a SWF is investing for “economic returns, political objectives, [or] securing strategic resources?” As evidenced by the failed China National Offshore Oil Corporation (“CNOOC”) - Unocal deal, political considerations play into exceed the ten-percent limitation). The purchase of a less than ten-percent stake in Blackstone, a U.S. private equity firm, by the pre-cursor of the Chinese SWF demonstrates the fluidity of the categories because it is the direct purchase of a U.S. company, which is also an alternative investment manager. Id.  

102 See The World’s Most Expensive Club, supra note 22 (arguing that the Chinese purchase of a stake in Blackstone could be understood as a political maneuver in response to growing protectionist sentiment).  

103 See Graham & Marchick, supra note 1, 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”). This “perfect storm” included nearly record high oil prices, strong anti-Chinese sentiment, and Chevron’s attempt to purchase the company. Id. at 129.
the concerns of regulators and the politicians that appoint them.\textsuperscript{104}

Calls by SEC Chairman Cox for the regulation of SWFs may reveal a political motivation because current securities regulations present little challenge to the operation of SWFs in the United States.\textsuperscript{105} Under the 1934 Act, direct investment in U.S. regulated companies by SWFs creates a requirement that they notify the company if they acquire more than five percent of a company.\textsuperscript{106} This requirement leads to information disclosure, but not necessarily regulation of the SWF, though it is analogous to the regulation of hedge funds.\textsuperscript{107} SWFs would face additional

\textsuperscript{104} The World’s Most Expensive Club supra note 22.

\textsuperscript{105} See Weiss, supra note 28, 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).

\textsuperscript{106} 15 U.S.C. § 78m(d).

\textsuperscript{107} Compare 15 U.S.C. § 78m(d) (requiring the disclosure of information by those owning more than five percent of a U.S. regulated company), with Johnson, supra note 23 (detailing the current regulatory approach toward hedge funds, which is receiving information from the regulated entities that lend to them).
reporting requirements and activity restrictions by acquiring more than ten percent of a U.S. regulated company.\textsuperscript{108} The restrictions on SWFs that is a beneficial owner of a U.S. regulated company involve the purchase and sale of shares, but these restrictions do not solve the regulatory challenge of enforcing these provisions across borders.\textsuperscript{109} Additionally, SWFs could use their position as insiders in their home country to purchase securities before they are offered to the general public, and then resell them to U.S. investors whether through a financial intermediary, or on the over-the-counter ("OTC") market.\textsuperscript{110} Finally, a SWF may expose itself to liability by selling unregistered securities to U.S. investors through

\textsuperscript{108} 15 U.S.C. §§ 78m-n

\textsuperscript{109} 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 18, § 6 (acknowledging the ineffectiveness of cross-border enforcement without foreign regulator cooperation).

companies that it controls.\textsuperscript{111} Once again, these provisions are meaningless without the ability to enforce them.

**B. The Status of SWF as a Sovereign Entity 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.\textsuperscript{112} FSIA requires a two-step analysis to determine whether the commercial activity exception to sovereign immunity applies in a given situation.\textsuperscript{113} The first step is to determine whether the activity

\textsuperscript{111} See 15 U.S.C. § 77(e) (prohibiting the sale or delivery of unregistered securities through the means of interstate commerce); see also Weiss, \textit{supra} note 28, at 8 (detailing the investments of the Chinese SWF, including its purchase of an investment company from a Chinese bank, which demonstrates that SWFs could potentially purchase entire companies should it suit their investment objectives).

\textsuperscript{112} See Power, \textit{supra} note 15, at 2727-41 (describing the judicially created doctrines of the restrictive theory of sovereign immunity, the act of state doctrine, and international comity).

\textsuperscript{113} See 28 U.S.C. §§ 1602-1611 (outlining the restrictive theory of sovereign immunity).
is commercial in nature. SWFs are engaging in an activity for the benefit of the state, but their activities are commercial in nature because they are investing to seek a profit instead of investing to protect the financial stability of the country by maintaining liquidity. The second step is determining whether the commercial activity is conducted in the United States or has a direct effect on the United States. For a 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

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

115 Id.

116 See Power, supra note 15, at 2728 (arguing that commercial activity in the United States, performed in connection with the United States, and acts affecting the United States will result in denial of sovereign immunity); see also supra notes 54-55 and accompanying text (discussing the restrictive theory of sovereign immunity and the conditions necessary for piercing the sovereign veil without an express waiver).
a U.S. regulator.\textsuperscript{117} 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.\textsuperscript{118} SWFs’ stated purpose is to reap a higher rate of return on the funds entrusted to it, and this necessarily implicates the commercial activity exception to sovereign immunity.\textsuperscript{119}

Any potential SWF transactions of concern to U.S. regulators would likely occur within the United States.\textsuperscript{120} Repayment of sovereign debt, which is the closest analogy to the

\textsuperscript{117} 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).

\textsuperscript{118} 28 U.S.C. § 1602; see Cox, supra note 3 (stating that neither international law nor FSIA would render SWFs immune from U.S. jurisdiction).

\textsuperscript{119} See Williams, supra note 31 (emphasizing the difference between a central bank’s prudential management of reserves and a SWF seeking a higher rate of return).

\textsuperscript{120} Cf. Cox, supra note 3 (noting that should a SWF engage in insider trading it would adversely impact the SEC’s mission to protect U.S. investors).
actors in a SWF transaction, is stipulated in a certain currency with payment designated in the country of the intermediary.\footnote{121}{See Power, supra note 15, 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).}

Potential 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 act is not an action performed within the sovereign’s territory.\footnote{122}{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).}

The nullification of the act of state doctrine likely depends on a contractual analysis to determine the place of payment.\footnote{123}{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}
the location of the payment or the location of the transaction determines whether the act of state doctrine applies. The possibility of a judgment barring repayment under the act of state doctrine increases the counterparty risk in a transaction.

SWFs challenge the notion of comity for financial regulators operating in an international context. The bottom line facing domestic regulators when “government is both the regulator and the regulated is that the opportunity for concepts, but ultimately upheld the decision because the parties stipulated a different branch location for collection. Id. at 666-68. See also supra notes 40-42 and accompanying text (discussing the requirements for the application of the act of state doctrine).

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).

Cf. Feder, supra note 40, 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 that innocent party without fulfillment of the contractual obligation it bargained for).
political corruption increases.\textsuperscript{126} 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.\textsuperscript{127}

Cox’s concern about the government being the regulator and the regulated conjures images of a monolithic government, which simultaneously invests and regulates investors, but this notion is imprecise as SWFs are specifically set up as separate government entities.\textsuperscript{128} Comity generally prescribes that U.S. agencies 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.

\textsuperscript{126} Cox, \textit{supra} note 3.

\textsuperscript{127} Compare \textit{Black’s Law Dictionary}, \textit{supra} note 59, at 114 (including mutual recognition of foreign executive action in its definition of comity), with Cox, \textit{supra} note 3 (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).

\textsuperscript{128} See \textit{First Nat. City Bank}, 462 U.S. at 628 (holding that these is a presumption of separate legal status for government created entities); see also \textit{supra} notes 18–20 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...
agencies 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.\textsuperscript{129} SWFs could not seek
refuge under the principles of comity because their actions
logically would be violations of U.S. law if the SEC is seeking
to enforce a securities law provision. Additionally, since there
is no territorial limitation to comity, the SWF status as a
foreign entity does not provide an exception to apply these
principles.\textsuperscript{130}

\textsuperscript{129} 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
continues 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.

\textsuperscript{130} See Power, supra note 15, at 2738-41 (noting the limited
utility of comity as a defense when actions are inconsistent
with U.S. policy).
C. The SEC Cannot Effectively Regulate SWFs 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)\textsuperscript{131} is ill-prepared to deal with the risks posed by SWFs. The focus of BITs is protecting covered investments from expropriation by a foreign government,\textsuperscript{132} giving most-favored-nation ("MFN") treatment to the other contracting party’s investors,\textsuperscript{133} guaranteeing repatriation of profits,\textsuperscript{134} and settling disputes that cannot be resolved through consultation and negotiation.\textsuperscript{135} Additionally, the U.S. Model BIT provides that foreign investors covered under the treaty shall be accorded national treatment in the establishment of investments.\textsuperscript{136} These provisions may actually work against a U.S.

\textsuperscript{131} U.S. Model BIT, supra note 14.
\textsuperscript{132} Id. art. 6.
\textsuperscript{133} Id. art. 4.
\textsuperscript{134} Id. art. 7.
\textsuperscript{135} 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, 3 (2005) (describing these as the typical key provisions of BITs).
\textsuperscript{136} See U.S. Model BIT, supra note 14, art. 3, ¶ 1-3 (stating that the favorable treatment accorded to foreign investors needs
regulator seeking to pursue legal action or impose restrictions on the actions of a SWF, for the reasons described below.\textsuperscript{137}

First, since a SWF is defined as an enterprise according to the U.S. Model BIT,\textsuperscript{138} it would need to be treated in the same manner as any other U.S. enterprise, which means that a U.S. regulator could not single out SWFs for any specialized regulation without facing a potential investment dispute.\textsuperscript{139} Current U.S. regulation to the analogous hedge fund is a hands-

\textsuperscript{137} See Hamilton & Rochwerger, supra note 135, at 1 (stating that BITs aim to protect investors from discriminatory regulation).

\textsuperscript{138} See U.S. Model BIT, supra note 14, 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.

\textsuperscript{139} 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).
The implication of national treatment is that U.S. regulators would need to treat SWFs in the same manner as hedge funds. U.S. regulators may circumvent the national treatment of foreign investors because the U.S. Model BIT permits 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. The application of

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140 See Hedge Fund Report, supra note 41, 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 41-42 and accompanying text (discussing the U.S. approach for hedge fund regulation).

141 See U.S. Model BIT, supra note 14, art. 3(2) (requiring the same treatment for foreign investors that the United States accords to U.S. investors, which includes hedge funds).

142 See id. art. 7, ¶ 4 (allowing the United States to prevent the transfer of dividends or other investment returns to SWFs that violate certain types of laws provided for in the BIT). Those are “laws relating to:
certain domestic laws may be allowed under the U.S. Model BIT, but that does not prevent a SWF from seeking arbitration.\textsuperscript{143} Finally, the U.S. Model BIT provides no impetus for foreign regulators to aid U.S. regulators by providing information regarding SWF activities.\textsuperscript{144}

The IOSCO MOU seems to be the SEC’s best option for pursuing a SWF and forcing SWF disclosures, but the MOU lacks effectiveness for two reasons: 1) it does not create a legally

| (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. |

\textsuperscript{143} Id. art. 24.  
\textsuperscript{144} Id. arts. 18-19 (allowing for the denial of information request due to “essential security interests,” or on the less onerous ground of it may “prejudice the legitimate commercial interest” of a public enterprise).
binding obligation,\textsuperscript{145} and 2) a foreign regulator can deny a request for assistance on the grounds of an essential national interest.\textsuperscript{146} These deficiencies are understandable when considered within the context of the harmonization versus equivalence debate.\textsuperscript{147} Forcing an information exchange may run contrary to a country’s regulatory regime preference.\textsuperscript{148} The

\begin{quote}
\textsuperscript{145} See IOSCO MOU, supra note 12, § 6(a) (stating as a general principle that the MOU does not supersede domestic laws).
\end{quote}

\begin{quote}
\textsuperscript{146} 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).
\end{quote}

\begin{quote}
\textsuperscript{147} See Vinuales, supra note 75, 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 infra note 75 and accompanying text (finding that 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).
\end{quote}

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\textsuperscript{148} See Vinuales, supra note 75, at 56-57 (noting that the Swiss authorities pay lip service to information exchange concerning
regulatory regime preference is hard to untangle from a country’s political or strategic motives when deciding to share information about a SWF’s investment activities. Without the legal imperative, it would prove difficult to elicit a foreign regulator’s support for U.S. regulation of that country’s SWF.

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).

See IOSCO MOU, supra note 12, § 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).

See Cox, supra note 3 (questioning the resolve of governments to cooperate with a fraud investigation when the target of the fraud is a 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.
D. Dashed Hopes for Indirect Regulation by the Federal Reserve Through Basel II Implementation

SWFs invest the excess reserves of their home countries.\textsuperscript{151} It is unlikely that they will participate in the financial system in the same manner as sovereign debt borrowers.\textsuperscript{152} 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.\textsuperscript{153}

\textsuperscript{151} See supra notes 19-34 and accompanying text (laying out the essential features of the SWF).

\textsuperscript{152} 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 a 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.

\textsuperscript{153} Compare U.S. Final Rule, supra note 18, at 6-10 (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 79-84 (discussing the implementation
The typical interaction between a SWF and an internationally active bank is likely to be an off-balance sheet item\textsuperscript{154} for the bank involving counterparty risk to which the BASEL II Accord does not apply a specific risk weighting.\textsuperscript{155}

\textsuperscript{154} See \textit{A Dictionary of Finance and Banking}, supra note 25, 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. \textit{Id.} at 113. See also supra note 83 (discussing off-balance sheet items).

\textsuperscript{155} See Basel II Accord, supra note 77, 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. \textit{Id.} The Basel II Accord, however, deferred a decision on how to handle counterparty
A unilateral move by U.S. banking regulators to require banks dealing with SWFs to take a higher capital charge could result in a move away from SWFs utilizing U.S. regulated banks resulting in less income for those banks.\textsuperscript{156} Thus, unilaterally imposing a higher capital charge leaves U.S. regulated banks at a competitive disadvantage as compared to non-U.S. regulated 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. \textit{Id.}

\textsuperscript{156} See U.S. Final Rule, \textit{supra} note 18, at 8-9 (stating that foreign subsidiaries of U.S. banks can avail themselves to “host jurisdiction definition[s] of default for retail exposures of the foreign subsidiary in that jurisdiction . . . ”); \textit{see also} Joel P. Trachtman, Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation, in \textit{Regulatory Competition and Economic Integration} 290-291 (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).
banks,\textsuperscript{157} and it does not necessarily prevent SWFs from dealing with a non-U.S. regulated subsidiary of a U.S. regulated bank.\textsuperscript{158} From a legal standpoint, U.S. banking regulators are free to change the requirements of the Basel II Accord because its provisions are not binding.\textsuperscript{159} From a practical standpoint, with

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\textsuperscript{157} See U.S. Final Rule, supra note 18, at 8 (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).

\textsuperscript{158} Cf. id. at 8-9 (differentiating between the approach for the wholesale transaction category, which SWFs would come under, 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).

\textsuperscript{159} See Lawrence C. Lee, Integration of International Banking Supervisory Standards: A Blueprint for the Taiwanese Banking System, \textit{Ann. Rev. of 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
\end{footnotesize}
\end{quote}
the institutional momentum of the Basel II Accords, it is not a viable option for the U.S. regulators to make substantive changes during the implementation of the BASEL Accords.\textsuperscript{160}

E. The False Panacea of Using the IMF Articles of Agreement to Regulate SWFs

There is a tension between the application of the restrictive theory of sovereign immunity and utilizing the IMF Articles of Agreement to regulate SWFs. This tension is that the restrictive theory of sovereign immunity treats the government entity as a commercial actor, but the non-self-execution doctrine implies that actors under the IMF Articles of Agreement are sovereign entities.\textsuperscript{161} Drawing the line between a sovereign’s effective, they are dependent upon national-level implementation and enforcement).

\textsuperscript{160} 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.

\textsuperscript{161} Compare Weltover, 504 U.S. at 614 (holding that the restrictive theory of sovereign immunity results in the classification of some government entities as commercial actors), with Em, 473 F.3d at 482-83 (holding that the powers
actions and a sovereign’s independently created agency becomes
difficult especially in the case of a SWF.\textsuperscript{162} SWFs invest a
country’s excess reserves,\textsuperscript{163} but seek a profit,\textsuperscript{164} and this
mixture of resources and motive leads to its 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.\textsuperscript{165}

\textsuperscript{162} Cf. Paul L. Lee, Central Banks and Sovereign Immunity, 41
\textit{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.”).

\textsuperscript{163} See \textit{Em}., 473 F.3d at 482-83 (holding that managing reserves is
sovereign in nature).

\textsuperscript{164} See supra notes 35-37 and accompanying text (explaining the
fiduciary duty of SWFs and the need to maximize the r/r
equation).

\textsuperscript{165} See 28 U.S.C. § 1605(a)(2) (piercing the sovereign veil for
the commercial activities of foreign states).
IMF members have an obligation to collaborate on policies concerning reserve assets as seen in Article VIII, section seven. 166 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 take on the position of the U.S. dollar in the world today. 167 The purpose of Article VIII, section seven is to prevent the use of capital controls that hurt international liquidity regardless of the general obligation found in this section to collaborate regarding exchange rate policy. 168 Additionally, the goal of making the SDR

166 See IMF Articles, supra note 18, art. VIII, § 7 (including the word “and” in between the provision for collaborating with respect to reserve asset management and the promotion of of the SDR as the principal reserve asset provision, thus creating a dual obligation).

167 Id., see generally Eichengreen, supra note 76 (arguing the momentum of the U.S. dollar prevented the SDR from assuming the U.S. dollar’s place in the international monetary system).

168 See IMF Articles, supra note 18, (stating that the aim of the mutual collaboration is to promote international liquidity and not specifically to monitor member’s reserve asset management).
the principal reserve asset makes it clear that Article VIII, section seven is intended to promote collaboration with respect to some reserve asset policies and not all reserve asset policies.\textsuperscript{169}

Article VIII, section five relates to the furnishing of information because not all countries have accepted the use of the SDR as a principal reserve asset.\textsuperscript{170} 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.\textsuperscript{171} Other

\textsuperscript{169} See id. (demonstrating that liquidity is the primary goal, which is understandable in a post-WWII era where concern focused on capital and current account controls, and not investment by states).

\textsuperscript{170} Id. at 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).

\textsuperscript{171} Id. at art. VIII § 5(vii); see Appleyard et al., supra note 10, at 459-63 (giving an overview of the international investment position of countries and stating that it is macroeconomic indicator that does not provide specific information on micro-level management of reserves).
provisions of section five require members to provide similar macroeconomic data.\textsuperscript{172} Most members of the IMF currently furnish some information, but are not required to furnish information about the investments made by SWFs.\textsuperscript{173} 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-WWII financial system where countries not only hold reserve assets, but utilize them for investment purposes.

IV. Recommendations

The international agreements outlined above offer little help to U.S. regulators concerned with SWF activity affecting

\textsuperscript{172} See generally IMF Articles, supra note 18, 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).

\textsuperscript{173} See IMF, The Data: Coverage, Periodicity, and Timeliness, http://dsbb.imf.org/Applications/web/sddsdatadimensions/ (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).
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. Even those that are non-binding prevent the United States from unilaterally making changes to them. Making changes to the existing framework has the advantage of speed whereas negotiating a multilateral investment framework would require a great deal of time and effort.

A. Recommendations for the U.S. Model BIT

The U.S. Model BIT offers the United States the best of hope for regulating SWFs. Currently, its provisions would block an attempt to single out a SWF for regulation separate than that accorded to 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. This

174 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).

175 See supra notes 156-60 (elucidating the challenges of unilaterally changing the Basel II Accord during U.S. implementation).
approach would require negotiation of a treaty and allow the other party to request concessions from the U.S. government.\textsuperscript{176}

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 U.S. to bind another country to provide information concerning SWFs when requested by U.S. regulators.\textsuperscript{177} The scope of this provision would need to include detailed accounting of foreign investments in the United States.\textsuperscript{176}

\textsuperscript{176} 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).

\textsuperscript{177} See generally IOSCO MOU, supra note 12 (providing a voluntary framework for sharing information for securities laws enforcement). But see IOSCO MOU, supra note, at § 6(a) (showing the MOU could only serve as a starting point since 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 it effectiveness and render it as useless in the context of regulating SWFs as the IOSCO MOU. See discussion supra notes 103–08 (determining the effectiveness of the IOSCO MOU with respect to the regulation of SWFs).
States. This provision would need to be binding, which is the major drawback with respect to the IOSCO MOU.\textsuperscript{178}

2. Single-out Government Investment Vehicles

Currently, the MFN and national treatment of countries allows for government entities that engage in commercial activities to receive the same treatment as a publicly held company.\textsuperscript{179} The U.S. should recognize that SWFs pose greater risks than the average foreign investor and should single out SWFs in the U.S. Model BIT.\textsuperscript{180} Information requests about SWFs should not be denied because of national security. They are operating in a commercial sphere, and should be treated accordingly.\textsuperscript{181} 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

\textsuperscript{178} See IOSCO MOU, supra note 12, § 6(a) (stating that the MOU is non-binding).

\textsuperscript{179} See U.S. Model BIT, supra note 14 arts. 3–4 (requiring like treatment between foreign and domestic investors).

\textsuperscript{180} See supra note 23 and accompanying text (detailing the comparative size of SWFs).

\textsuperscript{181} 28 U.S.C. § 1605(a)(2) (removing sovereign immunity for commercial activities by sovereign actors).
the USTR could maintain the overall goal of BITs to provide equal protection of foreign and domestic investors.

**B. Change the Capital Adequacy Requirements for Financial Intermediaries Dealing with SWFs that do not Adhere to Certain Transparency Requirements**

The next revision to the BASEL Capital Adequacy Standards should include provisions that recognize SWFs are a separate entity from the central bank and accord them different treatment. Currently banks can elect to treat SWFs as having the same creditworthiness\(^{182}\) as the central bank.\(^{183}\) Allowing banks to elect how they treat SWFs with respect to the capital charge they must assess when dealings with SWFs removes any leverage that a regulator could potentially apply to financial intermediaries in hopes of garnering disclosures about SWFs’ investment decisions. The U.S. cannot unilaterally change the regulations for the banks it manages because a SWF could simply

\(^{182}\) See *A Dictionary of Finance and Banking*, supra note 25, 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).

\(^{183}\) See supra note 86 and accompanying text (showing the discretion given to banks concerning SWFs).
utilize a foreign subsidiary of the same bank over which the U.S. does not have control. 184

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, 185 there are simple changes to the IMF Articles of Agreement that could make it easier to obtain information about

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

185 See Truman, supra note 28, 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).
SWFs. First, adding "individual investment positions"\textsuperscript{186} as a third category of reporting to Article VIII, section five(a)(i) would make this provision useful for those seeking more transparency from SWFs.\textsuperscript{187} Second, adding "with the exception of government sponsored investment vehicles"\textsuperscript{188} to the second line of Article VIII, section five(b) would add the obligation that members report data with sufficiency to cover SWFs.\textsuperscript{189}

\textsuperscript{186} The revised provision would read:

i) Official holdings at home and abroad of (1) gold, (2) foreign exchange, and (3) individual investment positions.

\textsuperscript{187} IMF Articles, supra note 18, at art. VIII § 5; see Truman, supra note 28, 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.

\textsuperscript{188} The revised provision would read:

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.

\textsuperscript{189} IMF Articles, supra note 18, at art. VIII § 5.
The United States and Western Europe could entice other IMF members to accept the changes in exchange for enhanced voting rights.\textsuperscript{190} Currently, control of the IMF is concentrated in those Western powers.\textsuperscript{191} The countries controlling the IMF generally do not have SWFs, and some of those without a proportionate share of voting rights control massive economies and have created SWFs. By exchanging SWF disclosure for enhanced voting rights, the IMF can become more democratic and create a relevant role for itself in the 21\textsuperscript{st} century.\textsuperscript{192}

\textbf{V. Conclusion}

The SEC and other U.S. regulators lack the tools to effectively regulate SWFs. They are investors and most of the SEC’s tools are framed around protecting investors and not regulating them. The disclosure regime of the SEC is focused on issuers and certain insiders. So far SWFs have not fit into either of these categories because they have elected not to appoint directors, they remain under the ten percent threshold of ownership after which an investor must file a disclosure with the SEC as a beneficial owner, and they have not become issuers.

\textsuperscript{190} Cf. Appleyard et al., supra note 10, at 749 (calling for greater transparency of IMF decision making).
\textsuperscript{191} Id.
\textsuperscript{192} Id.
As demonstrated, the international agreements to which the United States is a party offer little relief from the short comings of the domestic system. They provide no additional means with which to force 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 may lead to the conclusion that the talk about regulating them has less to do with the law and more to do with politics.
Appendix A

Countries with Sovereign Wealth Funds

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

Appendix B

IOSCO MOU Signatories:¹⁹⁴

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 (Finanstilsynets), Denmark

Dubai Financial Services Authority (DFSA), Dubai

Financial Supervision Authority, Finland

Autorité des marchés financiers, France

Bundesanstalt für Finanzdienstleistungsaufsicht (BAFin), Germany

¹⁹⁴ Source: IOSCO, List of Signatories to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange Of Information (2008),
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
Comision Nacional Bancaria Y De Valores (CNBV), Mexico
Conseil déontologique des valeurs mobilières (CDVM), Morocco
The Netherlands Authority for the Financial Markets (AFM), Netherlands, The
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 of America
Securities and Exchange Commission (SEC), United States of America
Appendix C

Countries with Bilateral Investment Treaties Currently In Force with the United States: 195

Albania
Argentina
Armenia
Azerbaijan
Bahrain
Bangladesh
Bolivia
Bulgaria
Cameroon
Congo, Democratic Republic Of (Kinshasa)
Congo, Republic Of (Brazzaville)
Croatia
Czech Republic
Ecuador
Egypt
Estonia

195 Source: Trade Compliance Center, Bilateral Investment Treaties Currently In Force

http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp
Georgia
Grenada
Honduras
Jamaica
Jordan
Kazakhstan
Kyrgyzstan
Latvia
Lithuania
Moldova
Mongolia
Morocco
Mozambique
Panama
Romania
Senegal
Slovakia
Sri Lanka
Trinidad and Tobago
Tunisia
Turkey
Ukraine
Uruguay