

Demystifying the Chinese Sovereign Wealth Fund Amidst U.S. Financial Regulation

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The United States (U.S.) Federal Reserve (Fed) categorized the China Investment Corporation (CIC) and Central Huijin Investment Limited (Huijin) as Bank Holding Companies under U.S. financial law, and granted CIC and Huijin some important conditional exemptions. These Exemptions, such as non-banking restrictions, are consistent with the prior practice of the U.S. Fed and crucial for the CIC and the Huijin to perform their functions. As shown by legal and factual analyses, the CIC currently does not intend to apply for Financial Holding Company status. Nevertheless, the CIC should pay close attention to regulatory principles such as the system-wide supervisory approach and the source of strength doctrine. In order to ease the widespread misgivings that the international community harbors against the CIC, China should enhance transparency, and join the global effort to govern and streamline the Sovereign Wealth Fund (SWF) in seeking mutual trust and cooperation.

I. INTRODUCTION

The China Investment Corporation (CIC) was established on September 29, 2007, with the issuance of special bonds worth RMB 1.55 trillion by the Chinese Ministry of Finance. In turn, the bonds were used to acquire approximately USD 200 billion of China's foreign exchange reserves to form the foundation of its registered capital. Because its financing is grounded in financial instruments

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and subject to commercial obligations, the CIC maintains a strict commercial orientation and is driven purely by economic and financial interests.

The CIC selects investments based on established investment principles and values. The CIC usually does not take a controlling role or seek to influence operations in the companies in which it invests. The CIC's fundamental approach is to hold, manage, and invest its mandated assets to maximize the shareholders' value. While every investment is unique, the CIC believes in the importance of having a long-term vision and, as a result, is committed to investing for the long-term. As a commercial investment institution, the CIC has full operational independence and makes investment decisions based on assessment of economic and financial objectives.

The CIC investments are not limited to any particular sector, location, or asset class and include equity, fixed income, and alternative assets. The CIC is committed to maintaining the highest professional and ethical standards of corporate governance, transparency, and accountability. The CIC's comprehensive corporate governance structure includes a Board of Directors, a Board of Supervisors, and an Executive Committee. The CIC is governed by the Company Law of the People's Republic of China and the CIC's Articles of Association and operating guidelines. While the CIC operates with independence and its investment decisions are based on the pure economics of each deal, the CIC remains accountable to the State Council of the People's Republic of China and, ultimately, to the citizens of the People's Republic of China.

Central Huijin Investment Limited (Huijin) is a wholly-owned subsidiary of the CIC with its own Board of Directors and Board of Supervisors. Huijin was established only to invest in key state-owned financial institutions in China, it does not conduct any other commercial activities and is not involved in day-to-day issues within the institutions in which it invests.¹

Thus far, this article has provided an overview of the CIC, and its wholly-owned subsidiary, Huijin. Of course, the mystery

¹ CHINA INVESTMENT CORPORATION OVERVIEW, http://www.china-inv.cn/cicen/about_cic/aboutcic_overview.html (last visited Feb. 8, 2010).

surrounding the CIC's foundation has not yet been clarified. On the contrary, the CIC's investment in the Blackstone Group, Morgan Stanley and Reserve Primary have drawn attention and controversy across the world. Meanwhile, several state-owned banks in which Huijin has ownership stakes have expanded overseas, especially in the U.S., which has provided an opportunity to observe U.S. legal treatment of the CIC's and Huijin's property, and to consider the current position and future trend of the two companies.

II. THE ACCESS TO THE U.S. MARKET AND THE FED'S APPROVAL

The CIC's Articles of Association states that [t]o the extent of its capital contribution, Huijin shall, on behalf of the State and in accordance with applicable laws, exercise the rights and perform the obligations of an investor in state-owned major financial enterprises, such as the Industrial and Commercial Bank of China (ICBC), the Bank of China (BOC) and the China Construction Bank (CCB), represent the State's controlling position in large-scale financial institutions, achieve value preservation, and enhance state-owned financial assets.²

The BOC operates two insured branches in New York and one uninsured branch in California. The ICBC's application of establishing a branch in New York was approved by the U.S. Fed on August 5, 2008, which granted authorization to engage in wholesale deposit-taking, lending, trade finance, and other banking services.³ Likewise, the CCB established its first American branch in New York on June 5, 2009.

Foreign banks operating in the U.S. are under the dual supervision of both the Federal and State governments. For example, the ICBC registration in New York had to be approved by the U.S. Fed and the New York State Banking Department. There was no uniform U.S. federal regulation for foreign banks before 1978, thus the issues concerning foreign banks were the

² See CHINA INVESTMENT CORPORATION ARTICLES OF ASSOCIATION (ABSTRACT), <http://www.china-inv.cn/governance/articles.html> (last visited Feb. 8, 2010).

³ *Industrial and Commercial Bank of China, Ltd., Beijing, P.R.C.*, 94 Fed. Res. Bull. C114 (2008), available at <http://www.federalreserve.gov/newsevents/press/orders/orders20080805a1.pdf> (last visited Apr. 30, 2010).

responsibility of each individual state. This arrangement left foreign banks beyond the restriction of federal regulations, which disadvantaged domestic U.S. banks and led to unequal treatment between domestic and foreign banks in the U.S. The U.S. Congress therefore enacted the International Banking Act (IBA) in 1978, which terminated the super national treatment enjoyed by foreign banks. The Act formulated, for the first time, federal law to regulate the establishment and operation of foreign banks, and created an environment for impartial competition between domestic and foreign banks. The Foreign Bank Supervision Enhancement Act, enacted in 1991, revised the IBA by adding a clause to reinforce the function of the U.S. Fed regarding supervising foreign banks and placing severe sanctions on foreign banks which violate U.S. law. From then, federal supervision of foreign banks has been harsher than state regulation. For example, the revised IBA stipulates that the establishment of a new branch must be approved by the U.S. Fed.⁴

Also, under Section 8 of the IBA, any foreign company that controls a foreign bank is subject to the Bank Holding Company Act (BHCA) as a bank holding company⁵. The BHCA, enacted in 1956, requires any company which directly or indirectly invests in banks or bank holding companies to gain approval from the U.S. Fed through filing an application. Factors that may trigger the requirement for examination include: (1) the company is in possession of more than 25% of the voting shares⁶ of a bank or a company; (2) the company holds the majority of the seats in the board of a bank or a company; and (3) the ability to cast controlling influence over the management or policies of a bank or a company. The U.S. Fed considers factors including the scope of investment, the level of the investors' involvement, the business relationship between investors and a bank holding company, and other factors illustrating the company's intention or ability to cast a controlling

⁴ See 12 U.S.C. § 3105(d) (2006).

⁵ 12 U.S.C. § 3103 (2006). Accordingly, when other non-banking deposit institutions, such as savings and loan holding companies serve as the target, other regulations, such as the Savings and Loan Holding Company Act, are adopted. The contents of the Savings and Loan Holding Company Act are similar to the BHCA. The supervisory institution for the Savings and Loan Holding Company Act is the U.S. Office of Thrift Supervision.

⁶ Except otherwise defined, "share" in this article refers to a voted share.

influence. The BHCA deemed that investors holding less than 5% of the shares of a bank or a company are unable to cast controlling influence over that bank or that company. In practice, the U.S. Fed would not classify investors who hold less than 10% of a bank or a company as casting controlling influence.⁷

For investments which are not required to be submitted for approval according to the BHCA, especially regarding investors who hold more than 10% of the shares of a bank or a company, the U.S. Fed requires prior reporting according to the Change in Bank Control Act. The Change in Bank Control Act sets the standard of the impact on competition and information disclosure when the U.S. Fed grants approval for investment. When analyzing whether to grant approval, the U.S. Fed is required to consider whether the investment would jeopardize the stability of bank finance or cast a negative influence on depositors or deposit insurance funds. The Change in Bank Control Act, however, does not require the same level of ongoing supervision and restriction as the BHCA.⁸

The BOC established a branch in the U.S. before Huijin was formed, and therefore, when Huijin was formed in December 2003 and invested in the restructuring of the BOC, the BOC reported to the U.S. Fed within ten days and revealed the shareholding change in its annual report, as required by U.S. law. Later, Huijin held 35.3% of the shares of the ICBC after it became a listed company (through Huijin, Ministry of Finance, Social Security Fund, the Chinese government holds about 74.8% of the shares).⁹ In the process of the ICBC establishing a branch in New York, the CIC and Huijin received detailed attention from U.S. financial supervision institutions, and the U.S. Fed asked the Chinese government for an explanation several times. The BHCA regulated the company's investments and thus excluded direct investment from foreign governments. However, since both the CIC and Huijin take the form of companies, the application under the BHCA could not be excluded. Upon the application of the CIC and Huijin through their U.S. attorneys, the U.S. Fed clarified the legal status of the CIC and

⁷ See 12 C.F.R. § 225 (2009).

⁸ 12 U.S.C. § 1817(j) (2006); 12 C.F.R. § 5.50 (2009).

⁹ See Xianfeng Yu, *Huijin Increases Its Share in the BOC, the ICBC and the CCB with 1.2 Billion RMB*, SHANGHAI SEC. NEWS, Dec. 4, 2008, at A1.

Huijin on August 5, 2008, the same date when the Fed issued order to approve the ICBC's application for opening a branch in New York.

III. THE CIC AND HUIJIN ARE BANK HOLDING COMPANIES SUBJECT TO CONDITIONAL EXEMPTIONS

The U.S. Fed clarified that the CIC and Huijin are subject to the BHCA, but at the same time granted conditional exemptions of certain restrictions and obligations under the authorization of Section 4(C)(9) of the BHCA.¹⁰ In principle, except for prior reporting for approval, all bank holding companies are subject to the supervision of the U.S. Fed, which includes examination, reporting and maintaining assets, and special restrictions on the mixing of banking and commerce. For example, banks are not permitted to purchase more than 5% of the shares of a non-banking company anywhere in the world without an exemption. When considering any application, the U.S. Fed will, under the guidelines set forth in the BHCA, consider factors such as competition, supervision, finance, and management. Management factors include the ability, experience, and personal integrity of the board members, senior managers, and major shareholders of the company and its subsidiary banks. Meanwhile, the BHCA has provided the U.S. Fed with a broad authority to exempt bank holding companies from restrictions and obligations under certain circumstances.

The CIC's and Huijin's requests for an exemption in accordance with BHCA § 4(C)(9) were honored by the Fed. BHCA § 4(C)(9) stipulates that shares held or activities conducted by any company organized under the laws of a foreign country, the greater part of whose business is conducted outside the U.S., if the Fed by regulation or order determines that, under the circumstances and subject to the conditions set forth in such regulation or order, the exemption would not be substantially at variance with the purposes of [the BHCA] and would be in the public interest.¹¹ Under the exemption, the CIC would be permitted to invest in any company,

¹⁰ Letter from Federal Reserve Board to H. Rodgin Cohen (Aug. 5, 2008) (upon request by the CIC and Huijin for a BHCA exemption).

¹¹ 12 U.S.C. §1843(c)(9) (1994).

including a U.S. company or a foreign company with U.S. operations, without regard to the non-banking restrictions of the BHCA. Huijin would be permitted to make investments in such companies directly or through its subsidiaries that are not bank-operated branches, agencies, or commercial lending companies in the U.S.. The exemption also covers banks controlled by the CIC or Huijin which do not have any operating branches, agencies, or commercial lending companies in the U.S.. By contrast, any foreign bank subsidiary of the CIC or Huijin that operates a branch, agency or commercial lending company in the U.S. (such as the BOC, ICBC, or CCB now) would remain fully subject to the Fed's Regulation K and Y with respect to its activities and investments and would be treated the same as any other foreign banking organization.¹²

These exemptions are conditioned on compliance by the CIC and Huijin with several limitations. First, all transactions by a U.S. branch or agency of any foreign bank subsidiary of the CIC or Huijin with a company in which the CIC or Huijin has made a controlling investment would be limited.¹³ Transactions by a U.S. branch or agency with a single controlled company are limited to 10% of the branch's or agency's lending base, and transactions with all controlled companies in the aggregate are limited to 20% of the branch's or agency's lending base.¹⁴ All such transactions must be fully collateralized. Any transaction between a U.S. branch or agency and a controlled company must be on the arm's length market terms. The U.S. branches and agencies of foreign bank subsidiaries of the CIC and Huijin may not engage in cross-marketing goods or services within the U.S. together with such controlled companies.

Second, both the CIC and Huijin must continue to conduct a majority of its business outside the U.S., consistent with the requirements of BHCA § 4(c)(9).

¹² 12 C.F.R. §§ 211, 225 (2009) (Regulation Y regulates the international activities of U.S. banks' and foreign banks' activities in the U.S., while the Regulation K mainly serves as the implementing rule of the BHCA and the Change in Bank Control Act.).

¹³ 12 U.S.C.A. § 371c(b)(7)(2009) (transactions including lending, purchasing securities, purchasing assets, accepting securities as pledges, and offering guarantees).

¹⁴ The lending base here has been set as 5% of the third party assets.

Third, the CIC and Huijin may not directly or indirectly (including in combination) acquire control of or exercise a controlling influence over a security company, an insurance company, or any other company that engages in activities in the U.S. that are permitted only to a financial holding company under BHCA § 4(k), unless the CIC and Huijin meet the standards of, and elect to be treated as, financial holding companies.

Fourth, the CIC and Huijin or any company, including any foreign bank, that is controlled by the CIC or Huijin are required to obtain prior Fed approval to make a direct or indirect investment of 5% or more of the voting shares of a bank holding company or a U.S. bank, or to make a controlling investment in a corporation organized under Federal Reserve Act § 25(a).¹⁵ Likewise, prior Fed approval is required for the acquisition of a controlling interest in a U.S. insured depository institution.

The Fed also has determined to exempt the CIC and Huijin from the regular reporting, filing, and capitalization requirements of the BHCA and the Fed's regulation. These exemptions are again conditioned on compliance by the CIC and Huijin with the following two limitations:

First, with respect to reporting, the CIC and Huijin must inform the Fed of any acquisition of 25% or more of the shares of any company that engages in activities in the U.S., or any acquisition of more than 5% of the shares of any company that engages in activities that only a financial holding company may conduct in the U.S. The CIC and Huijin are not required to report separately on any investment that is made by one of their subsidiary foreign banks that is subject to the BHCA where such investment has been reported by that bank to the Fed as part of the bank's regular reporting requirement.

Second, the CIC and Huijin must monitor investments made by their controlled companies to determine whether, in the aggregate, such investment might trigger an application threshold with respect to a U.S. depository institution or cause the CIC or Huijin to be

¹⁵ 12 U.S.C. §§ 611, 619 (2006). For example, Edge Corporation, which was first established in 1919, has had its structure and activities go through multiple variations. It is under the supervision of the Fed and can be classified as a non-banking entity (engaged in equity investment in overseas financial institutions) or as a banking type (engaged in purchase of commercial paper and international banking activities). The IBA in 1978 started to allow foreign banks to gain control over the Edge Corporation.

considered to be in control of a company that owns a U.S. depository institution.

IV. THE FED'S CONSIDERATIONS: SIMILARITIES AND DIFFERENCES

In general, the Fed's exemption did not erect extra barriers for the CIC and Huijin, and the practice was in compliance with precedents. The accessory conditions, especially the restrictions on non-banking businesses, is meant to guarantee the stability of American banking institutions, reduce the possibility of interest conflicts, avoid recourses over-concentrated and improper banking activities, enhance the supervision capability of the Fed, and to balance the CIC's and Huijin's and their controlling companies' potential advantages attributed to the exemption. For example, the second condition is derived from the requirements of BHCA § 4(c)(9) itself, and the fourth condition is a normal requirement for foreign banks' controlling companies.¹⁶ The first condition applies not only to all foreign banks' branches in the U.S., but also is similar to the requirements set forth for domestic banks in the Federal Reserve Act.¹⁷ Federal Reserve Act § 23A mandates that the aggregate amount of covered transactions between member banks and any single affiliate of their affiliates shall not exceed 10 per centum of the capital stock and surplus of such member bank and that the aggregate amount of covered transactions, with all their affiliates, shall not exceed 20 per centum. Federal Reserve Act § 23B further emphasizes that all related transactions conducted by the member bank shall be at arm's length terms.¹⁸ Obviously, these conditions seek to prohibit the controlling company of the bank from harming the bank's interest for the sake of other subsidiaries, rather than casting special limitations on the CIC and Huijin.

Comparative observation also shows that this exemption is consistent with the Fed's prior practices. Issues similar to the CIC and Huijin cases first arose in 1980s.¹⁹ When dealing with an application by an Italian bank – IRI, a wholly government-owned

¹⁶ 12 C.F.R. § 225.124 (2009).

¹⁷ 12 U.S.C. § 1828(j)(1) (2006) (expanding this requirement to all banks under insurance of FDIC).

¹⁸ 12 U.S.C.A. § 371(c) (2009).

¹⁹ *Banca Commerciale Italiana*, 68 Fed. Res. Bull. 423 (1982).

financial public corporation, the Fed reiterated that the BHCA applies to foreign government-owned companies, but not foreign governments. Meanwhile, the Fed noted that Congress had provided it with broad authority to exempt foreign companies from the BHCA, and while limiting the scope of the application of the U.S. regulatory framework, such exemption was granted to IRI to respect other countries' choices of economic structures and to bolster the public interest of the U.S.. The Fed also determined to apply this exemption to other similar foreign government-owned companies, as long as any bank operating business in the U.S. by such foreign government-owned companies was in the form of either branch or agency, not a legal person bank.²⁰

On the other hand, the Fed's possible misgivings toward the CIC and Huijin arose from three main aspects: first, general concerns about the unprecedented scale of the foreign Sovereign Wealth Funds (SWFs); second, special precautions against the Chinese SWF; and third, a lack of confidence in Chinese financial supervision. The Fed's possible misgivings regarding the CIC and Huijin were evidenced in the Fed's order on the CIC's and Huijin's application for exemptions, when the ICBC established its New York branch, and during the Fed's Testimony on SWFs before the Subcommittees of U.S. House of Representatives,²¹ when the Fed defined the CIC and Huijin as SWFs.

SWFs are investment funds or arrangements owned by federal or state governments, and are commonly established separate from their official foreign currency operations. The first SWF, Kuwait Investment Authority, was established in 1953. The source and purpose of SWFs mainly fall into three categories. First, many SWFs were originally set up to help stabilize revenues from the sale of a commodity, such as oil, natural gas, or other commodities, and to provide a way to preserve and grow wealth for future generations. Chile and Botswana established sovereign wealth funds based on their revenues from the sales of copper, diamonds,

²⁰ Letter from Federal Reserve Board to Patricia S. Skigen (Aug. 19, 1988).

²¹ *Sovereign Wealth Funds: Hearing Before the Subcomm. on Domestic and International Monetary Policy, Trade, and Technology and the Subcomm. Capital Markets, Insurance, and Government Sponsored Enterprises of the Comm. on Financial Serv.*, 110th Cong. 2-3 (2008) [hereinafter *Hearing*] (testimony of Scott G. Alvarez, General Counsel, Federal Reserve Board), available at <http://www.federalreserve.gov/newsevents/testimony/alvarez20080305a.htm>.

and phosphate, and the examples of governments that have established funds using oil revenues include Norway, Kuwait, and Qatar. Second, some developed nations have established SWFs by using social security or government pension fund surpluses and contributions from taxes and other government revenues. Such funds are invested in a wide range of domestic and foreign assets with the aim of supplementing the future means of financing social security or government pension programs. Countries using these kinds of SWFs include France, Australia, and New Zealand. Third, other SWFs have been established to make more profitable use of foreign exchange reserves accumulated. Countries such as Singapore, Korea, and China belong to the third category of SWF. Currently, there are approximately 40 SWFs worldwide.²²

The U.S.'s concerns about the SWFs of other countries have risen along with their massive scale, rapid increase, and extensive investment in American financial institutions. At present, the total assets of SWFs amount to approximately USD 3.3 trillion. Norway's SWF has exceeded USD 350 billion, and China and Singapore's SWFs have also reached hundreds of billions of U.S. dollars. The total amount of SWFs has quadrupled from 2003 to 2007. Since the financial turmoil, entities like the Kuwait Investment Authority, the Abu Dhabi Investment Authority, the Government of Singapore Investment Corp., and others, have invested in Citibank. The Korean Investment Corp., the Kuwait Investment Authority and the Singapore Temasek became shareholders of Merrill Lynch. The CIC itself held shares of Morgan Stanley. Such moves have drawn great attention worldwide. There are concerns that these investments made by foreign investors are not in the pursuit of maximum return, but instead are focused on the realization of political or strategic goals of certain foreign governments. Strategic goals appear to be obvious in SWFs, especially when their investment targets involve financial institutions which are the economic lifeblood of a given country.

As for the Chinese SWF, two major issues stand out. First, the source of the capital in the CIC and Huijin were China's foreign

²² Int'l Monetary Fund [IMF], Monetary and Capital Markets Dep't, *Working Paper: Sovereign Wealth Funds: Current Institutional and Operational Practices*, IMF Doc. WP/08/254 (Nov. 2008), available at <http://www.imf.org/external/pubs/ft/wp/2008/wp08254.pdf> (last visited Feb. 8, 2010).

exchange reserve. There has long been an accusation of disequilibrium in Chinese trade and the Chinese government has been accused of manipulating the foreign exchange rate. One of the well-known incidences was the bill proposed by U.S. Senator Charles Schumer, who threatened to impose a punitive tariff of 27.5% against China.²³ Another example was the comment titled “Asia’s Revenge” by the Chief Economic Commentator of the *Financial Times*, Martin Wolf. In this comment, he mentioned that China was the country with the largest trade surplus in the world in 2007, while 44% of the total amount of world surplus flowed into the U.S. Meanwhile, by quoting the estimate of Carmen Reinhart of the University of Maryland and Kenneth Rogoff of Harvard University, Mr. Wolf claimed that “over a trillion U.S. dollars was channeled into the subprime mortgage market,” and alluded that the U.S. dollar surplus held by China and other countries, as well as China’s excessive savings have fostered the capital bubble and the financial crisis in the U.S. and other developed countries.²⁴ Ben Shalom Bernanke, the U.S. Fed Chairman, has also made mild but similar remarks, mainly from academic and policy positions.²⁵

Second, in spite of the CIC’s claim that its main goal for overseas investment is gaining profit; concerns have grown in Europe and the U.S. to the point of the CIC was defiled as a locust or a vulture, and that the CIC serves as means of the Chinese government to gobble up companies in targeted countries. The CIC’s intentions have long been suspected. CBS’s 60 Minutes conducted an exclusive interview with Gao Xiqing, the President of the CIC that gave an all-round picture of such mistrust between the two sides.²⁶ Ironically, the CIC, which was accused as being non-transparent, provided a download link of this interview on its own website.

²³ S. 295, 109th Cong. (2005), available at <http://www.govtrack.us/congress/billtext.xpd?bill=s109-295> (last visited Feb. 8, 2010).

²⁴ Martin Wolf, *Asia’s Revenge*, FIN. TIMES, Oct. 8, 2008, at 13 (U.K.), available at <http://www.ft.com/cms/s/0/fba32c1e-9565-11dd-aedd-000077b07658.html>.

²⁵ Mark Landler, *Dollar Shift: Chinese Pockets Filled As Americans’ Emptied*, N.Y. TIMES, Dec. 26, 2008, at A1.

²⁶ Shachar Bar, *China Investment An Open Book? 60 Minutes: Sovereign-Wealth Fund’s President Promises Transparency*, CBS NEWS, Apr. 6, 2008, <http://www.cbsnews.com/stories/2008/04/04/60minutes/main3993933.shtml> [hereinafter *China Investment An Open Book?*].

In addition, when examining foreign banks conducting business in the U.S., the Fed usually considers the following factors: (1) whether the supervisory institution in its home country has conducted comprehensive or consolidated supervision over the bank; (2) how would the supervisory institution conduct supervision on relations and transactions between the bank and its related parties, the latter including SWFs and other holding shareholders; (3) whether the foreign bank has adopted and implemented procedures to combat money laundering; (4) the financial and managerial resources of the foreign bank; (5) whether the foreign bank has provided the Fed with adequate assurances that the bank will make available information about its operations or activities; and (6) whether appropriate authorities in the home country of the foreign bank have consented to the proposed establishment of a branch, agency, or commercial lending company in the U.S. by such foreign bank.²⁷

“[C]omprehensive or consolidated supervision” means that the home country supervisors could: (1) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (2) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or other means; (3) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (4) receive the bank’s financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank’s financial condition on a worldwide consolidated basis; and (5) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis.²⁸

In its order approving the ICBC establishing a branch in the U.S.,²⁹ the Fed determined that Chinese supervisory authority is “actively working to establish” arrangements for comprehensive or consolidated supervision. Such approval actually relied on an exceptional clause of the above standard, “actively working to establish.”³⁰ In contrast, when examining an application by

²⁷ 12 U.S.C. § 3105(d) (2006).

²⁸ 12 C.F.R. § 211.24 (2009).

²⁹ *Industrial and Commercial Bank of China, Ltd., Beijing, P.R.C.*, 94 Fed. Res. Bull. C114 (2008).

³⁰ 12 U.S.C.A. § 3105(d)(6)(A) (2006).

Mitsubishi Tokyo Financial Group (now MUFG), the Fed determined that the company was under the comprehensive or consolidated supervision of the Financial Service Agency, the Japanese regulator.³¹ Therefore, it could be demonstrated by comparison that the U.S. still put doubts upon the independence and capability of Chinese financial supervision, especially when it comes to companies like the CIC.

V. ADAPTATION, BEHAVIOR, AND COMPLIANCE

China has been making an active effort to reach consensus and ease concerns. For example, during the fourth Strategic Economic Dialogue between China and the U.S. in June 2008, the orientation of the CIC was one of the topics discussed. Right after that dialogue, Huijin reorganized its board of directors. Except for Lou Jiwei, who is currently the CIC's Chairman, none of the four other members—Li Jiange, Xie Ping, Wu Xiaoling, and Jin Shulian, holds any position in the CIC. Apparently, the separation of personnel between the CIC and Huijin was intended to strengthen the independence of each company. Meanwhile, Gao Xiqing, the President of the CIC, emphasized that the CIC would stick to the principle of not seeking control, avoiding sensitive areas, holding onto long-term investments, and achieving high-levels of transparency, with an effort to establish mutual trust through the American mainstream media.³²

It should be noted that the orientation and exemption given by the Fed favor the future operation of the CIC and Huijin. Especially the exemption on the non-banking business restrictions is essentially important for the CIC, which plans to invest worldwide in different assets in the forms of equity, fixed income interests, and others. Without the exemption, diversified investments matching regions, industries, and stages of investment would be extremely difficult to accomplish.³³ Meanwhile, the exemption from regular

³¹ 87 Fed. Res. Bull. 349 (2001).

³² See *China Investment An Open Book?*, *supra* note 27.

³³ Lou Jiwei, the CIC Chairman, among the others, has expressed that the CIC would disperse its investments geographically and put more emphasis on developing countries and regions, see 陈思武 & 陈济朋, 楼继伟: 欧美国家政策未明朗, 中投不会大规模投资, 新华网, Chen Siwu & Chen Jianming, *Lou Jiwei: Ou mei guo jia zhen ce wei ming lang Zhong Tou bu hui da gui mo tou zi* [Lou

reporting, filing, and capitalization requirements are also quite favorable for the CIC and Huijin. The exemptions improve the timing, efficiency, and confidentiality of decision-making, and are beneficial to its full operational independence.

On February 5, 2010, the CIC for the first time filed Form 13F with the Securities and Exchange Commission (“SEC”), which is required in the U.S. for institutional investors or mutual funds, and disclosed its stakes in companies publicly traded in the U.S. Within the total USD 9.6 billion worth of shares as of the end of year 2009, the statistics helped prove that the Chinese SWF was apolitical and taking minority positions responsibly. Thanks to the Fed’s conditional exemptions, the CIC invested with more autonomy in areas such as commodities, real estate, and infrastructure in Australia, Canada, and the U.S., in addition to the traditional financial sector. Also, to address worries about how China’s holdings of U.S. Treasury securities could be hurt by inflation or by soaring U.S. debt, the CIC purchased the securities of international companies, allowing China to spread its fast-growing wealth more widely and securely. The following table lists some companies in which the CIC have invested.³⁴

Name of Issuer	Value (x USD 1000)	Shares Amount (x 1000)
Apple	6,326	30
Bank of America	19,888	1,333
Citigroup	29,790	9,000
Coca Cola	9,012	158
Goodyear Tire	1,410	100
Johnson & Johnson	9,339	145
Merck	7,308	200
Morgan Stanley	1,772,761	59,891
Motorola	3,880	500
Pfizer	2,821	155
Teck Resources	3,542,617	101,304
Visa	353,815	4,045

Jiwei: The Policy of Euramerican Country Is Not Clear, CIC Will Not Invest in Large Scale, WWW.NEWS.CN, Dec.3, 2008, http://news.xinhuanet.com/fortune/2008-12/03/content_10451850.htm (last visited May. 28, 2010).

³⁴ China Investment Co., Holdings Report (Form 13F) (Feb. 5, 2010), <http://www.sec.gov/Archives/edgar/data/1468702/000095012310009135/c95690e13fvhr.txt> (last visited May. 28, 2010).

At the same time, as bank holding companies under U.S. law, the CIC, Huijin, and their controlling state-owned banks, such as the ICBC, are subject to the following requirements. First, the entities must comply with the supervision of Fed. Since 1999, the Fed has classified foreign banks into three categories: large complex banking organizations; multi-office organizations; and regional organizations, in view of the foreign banks' operational scale and complexity, amount of settlement, portfolio of custodian, and complexity of individual supervisory structures.³⁵ In October 2008, the Fed stipulated further requirements for the supervision of foreign banks and bank holding companies on a comprehensive basis, which depend on the above factors.³⁶ The Fed does not publicly announce its classification of a particular foreign bank or bank holding companies. Since their current operation scales are still small in the U.S., banks such as the BOC or the ICBC are unlikely to be treated as large complex banking organizations, yet the BOC and the ICBS should stay aware of and be ready for the U.S. Fed's possible supervision.

Second, all related Chinese entities should be well coordinated between each other. As the three banks controlled and owned by Huijin expand their operations in the U.S., and while the CIC makes further investments, complex issues may arise, such as aggregating in calculation, transactions involving related parties, and conflicts of interest. Obligations undertaken by each of them, ranging from information disclosure to business restrictions, demand that the CIC and Huijin must establish certain information and early warning mechanisms in a systematic manner. In addition, the U.S. tends to treat the CIC's investment and that of the Chinese foreign exchange reserve as the same investment, and therefore the coordination among the CIC, the People's Bank of China, the State Administration of Foreign Exchange, and the Ministry of Finance is equally essential.

³⁵ Supervisory Letter on Framework for Financial Holding Company Supervision, SR 99-15 (SUP) (1999), available at <http://www.federalreserve.gov/boarddocs/srletters/1999/sr9915.htm>.

³⁶ Supervisory Letter on Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations, SR 08-9/CA 08-12 (2008), available at <http://www.federalreserve.gov/boarddocs/srletters/2008/SR0809.htm>.

Third, the CIC and Huijin should attach great importance to the potential impact of the principle of the source of strength doctrine. The Fed tends to view bank holding companies as the source of strength of their controlled banks, which means that the bank holding companies shall not only possess adequate resources in management and finance, but also shall be obligated to put those resources in saving the controlled bank from actual crisis. Such obligations may sometimes even preempt the limited liability protection available for shareholders under normal circumstances. The principle of the source of strength doctrine once was supported by the U.S. Supreme Court,³⁷ but then was restricted by the statute.³⁸ The CIC and Huijin must remain cautious of their potential responsibilities under this principle even though the peril of its application is not imminent.

VI. FINANCIAL HOLDING COMPANY: AN OPTION TO TAKE?

Within both of the two sets of conditions to the Fed's exemptions, the term "financial holding companies" was mentioned, which is a special kind of bank holding company initially introduced by the Gramm-Leach-Bliley Act.³⁹ Based on a revision of the former BHCA,⁴⁰ financial holding companies under the Gramm-Leach-Bliley Act are permitted to be engaged in or hold shares of companies conducting the following businesses: (1) financial in nature; (2) incidental to financial business;⁴¹ and (3) supplementary to financial business. The financial holding companies are allowed to participate in those transactions because those transactions would not pose a substantial threat to the safety and stability of deposit-banking institutions or to the financial system in general.

Businesses that are financial in nature include: lending, trading, transferring, brokering, custodian of money or securities, underwriting, dealing, market making, issuing or selling collective

³⁷ See, e.g., *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234 (1978).

³⁸ See Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236; Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989); *MCorp Fin. Inc. v. Bd. of Governors*, 900 F.2d 852 (5th Cir. 1990).

³⁹ Macey Jonathan R., *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 J. CORP. L. 691, 709 (2000), available at <http://ssrn.com/abstract=245476>.

⁴⁰ 12 U.S.C. § 1843(k) (2006).

⁴¹ See *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995); *Arnold Tours, Inc. v. Camp*, 400 U.S. 45 (1970).

investment instruments representing interests in a pool of assets permissible for a bank to hold directly, insurance, financial investment counseling, and merchant banking, among others.⁴² The Gramm-Leach-Bliley Act authorized the Fed and the Department of the Treasury to extend such scope and to define the business incidental to financial business, upon the applications of financial industries.⁴³ As for the supplementary activities, the law only granted the Fed with approval power, without much specification.⁴⁴

When compared with ordinary bank holding companies, which can only engage in banking or businesses closely related with banking,⁴⁵ financial holding companies' scopes of business are much broader.⁴⁶ For example, for the security business, a financial holding company needs to file a report with the Fed within 30 days after the launch of operation. By contrast, except for certain kinds of securities, the ordinary bank holding companies must obtain prior approval from the Fed in order to engage in security business, and mostly operate through the so called Section 20 subsidiary.⁴⁷ The Section 20 subsidiary is subject to the following restrictions: eight prudential limitations or operating standards designed by the Fed to address certain safety and reasonableness concerns⁴⁸; limited by the terms of its Fed's approval in the types of securities that it may underwrite or deal in; and deriving no more than 25 percent of its gross revenue from underwriting or dealing in bank-ineligible securities. Furthermore, no Section 20 subsidiary may underwrite or deal in shares of an open-end investment company or mutual fund.⁴⁹

In order to be treated as a financial holding company in the U.S., a foreign bank or its controlling company shall satisfy the requirement that both the bank and its U.S. subsidiary are and remain well capitalized and well managed.⁵⁰ A foreign bank will be

⁴² 12 U.S.C. § 1843(k)(4) (2006).

⁴³ 12 U.S.C. § 1843(j) (2006).

⁴⁴ 12 U.S.C. § 1843(j)(1)(A) (2006).

⁴⁵ 12 U.S.C. § 1843(c)(8) (2006).

⁴⁶ 12 C.F.R. § 225.86 (2009).

⁴⁷ See Li Guo, *Financial Holding Company or Universal Bank? A Comparative Note on the Latest Amendment to China's Commercial Bank Law Art. 43*, 121 *BANKING L.J.*, 883, 891–893 (2004).

⁴⁸ The Fed may temporarily apply the last two restrictions (25% and mutual fund) to financial holding companies.

⁴⁹ The Federal Reserve Board, *Securities Underwriting and Dealing Subsidiaries*, available at <http://www.federalreserve.gov/generalinfo/subsidiaries/> (last visited May 28, 2010).

⁵⁰ See 12 U.S.C. § 1843(l) (2006).

considered “well capitalized” if: (1) its home country supervisor has adopted risk-based capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord); (2) the foreign bank maintains a Tier 1 capital to total risk-based assets ratio of 6 percent and a total capital to total risk-based assets ratio of 10 percent, as calculated under its home country standard; and (3) the foreign bank’s capital is comparable to the capital required for a bank owned by a U.S. financial holding company.

A foreign bank will be considered “well managed” if: (1) the U.S. branch of such foreign bank has received satisfactory or above ratings during its most recent assessment; (2) the home country supervisor of the foreign bank consents to the bank expanding such business in the U.S., as permissible only for a financial holding company; (3) the management of the foreign bank meets standards comparable to those required of a bank owned by a U.S. financial holding company.⁵¹

Any foreign bank or company that controls such a bank must file a written declaration with the Fed, which states that the foreign bank or company elects to be treated as a financial holding company as long as it has satisfied the two sets of requirements above. Before filing a declaration, the foreign bank or company may file a request for preliminary review of its qualifications. Where the foreign bank is not found passing the comprehensive or consolidated basis supervision test by the Fed, or from a country where no other banks have ever been so found, the foreign bank must go through such a preliminary review.⁵²

In 2008, Japanese MUFG was approved to become a financial holding company under U.S. laws in an effort to become a shareholder of Morgan Stanley.⁵³ Morgan Stanley itself was authorized, two weeks before MUFG’s authorization, to become a bank holding company. With the goal to become a financial holding company eventually, Morgan Stanley has been making

⁵¹ 12 C.F.R. § 225.90 (2009).

⁵² 12 C.F.R. § 225.91 (2009).

⁵³ Federal Reserve Board letter to Donald J. Toumey, Esq., (Oct. 6, 2008).

adjustments regarding its investments and business structures to meet the applicable requirements, during the transition period.⁵⁴

Gaining the status of being an official financial holding company is accompanied by more than complicated and comprehensive financial supervision. The Gramm-Leach-Bliley Act authorized the Fed to be an umbrella regulator, while the SEC, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and state insurance supervisory institutions have kept their chief functional regulations regarding financial holding companies.⁵⁵ The Fed may not prescribe regulations, issue or seek entry of orders, impose restraints, restrictions, guidelines, requirements, safeguards, standards, or otherwise take any action under or pursuant to any provision of the Gramm-Leach-Bliley Act or Section 8 of the Federal Deposit Insurance Act against or with respect to a functionally regulated subsidiary of a financial holding company, unless the action is necessary to prevent or redress an unsafe or unsound practice or breach of fiduciary duty by such subsidiary that poses a material risk to the financial safety, soundness, or stability of an affiliated depository institution, or the domestic or international payment system. But when the Fed finds that it is not reasonably possible to protect effectively against the material risk at issue without action,⁵⁶ its supervisory activities could fall into three broad categories: information gathering, assessments and supervisory cooperation; ongoing supervision (including the financial holding company's structure, management, and the application process, reporting and examination, capitalization requirements; intra-group exposures, and concentrations and enforcement powers); and promotion of sound practices and improved disclosure.⁵⁷

In China, Huijin controls several commercial banks and invests in securities companies like Yin He Securities Co. Ltd., Shenyin & Wanguo Securities Co. Ltd., and Guotai Junan Securities Co. Ltd. In the fourth Strategic Economic Dialogue between China and the U.S.

⁵⁴ See 94 Fed. Res. Bull. C103 (2008), available at <http://www.federalreserve.gov/pubs/bulletin/2008/pdf/legalq308.pdf>.

⁵⁵ 12 U.S.C. § 1844(c) (2006).

⁵⁶ 12 U.S.C. § 1848(a) (2006).

⁵⁷ Supervisory Letter on Framework for Supervision of the Financial Holding Companies, SR 00-13 (2000), available at <http://www.federalreserve.gov/boarddocs/srletters/2000/sr0013.htm>.

in June 2008, the U.S. proposed to treat the CIC and Huijin as financial holding companies. If so determined, the two companies' investments and operations in the U.S. would have received more severe supervision and restriction. In fact, however, the Fed's reply and exemptions indicated that the CIC and Huijin are treated as ordinary bank holding companies under U.S. law. The CIC has also made clear that it currently bears no intention of becoming a financial holding company.⁵⁸

The CIC's declaration may be based on the following considerations: (1) financial fields in China still operate following the principle of separate operation and business segregation;⁵⁹ (2) most SWFs' investments in U.S. financial institutions are usually below 10% (mostly less than 5%) which emphasizes the concept of "uncontrolled" in order to refrain from triggering more strict supervision;⁶⁰ and (3) the worldwide financial situation at present remains at unrest; while American securities and insurance companies have been suffering from unprecedented crisis, state-owned companies like the CIC have been extremely prudent with any expansion at this time.⁶¹

In fact, the CIC bought 9.9% preferred equity interest of Morgan Stanley at the cost of USD 5 billion in December 2007. There were once rumors that the CIC might increase its share to 49% in September 2008. However, it was Japanese MUFG, the later U.S. financial holding company, which finally bought 24.9% of the shares of Morgan Stanley, at a cost of USD 9 billion. The Fed imposed restrictions on approving the transaction, including MUFG's commitment of not casting a controlling influence.⁶² Therefore, the similar requirement—the third restrictive condition to the CIC's

⁵⁸ 法林, 解读美联储来函, 财经, Fa lin, Jie du mei lian chu lai han [*The CIC's decipherment of the Board's Reply*], CAIJING MAG., Sept. 29, 2008, at 106.

⁵⁹ 证券法, Zheng juan fa [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1998, effective Jan. 1, 2006) 2005 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. 586, act. 6 (P.R.C.); 商业银行法, Shang ye yin hang fa [Law on Commercial Banks] (promulgated by the Standing Comm. Nat'l People's Cong., May 10, 1995, effective July. 1, 1995) 1995 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. 300 (amended by the Standing Comm. Nat'l People's Cong., Dec. 27, 2003, effective Feb. 1, 2004), act. 43 (P.R.C.).

⁶⁰ Hearing, *supra* note 22.

⁶¹ Lou Jiwei, the CIC Chairman, Talk at Clinton Global Initiative (Dec. 3, 2008), *available at* <http://cn.reuters.com/article/wtNews/idCChina-3037920081203> (last visited Feb. 8, 2010).

⁶² 95 Fed. Res. Bull. B35 (2009), *available at* <http://www.federalreserve.gov/pubs/Bulletin/2009/legal/q408/order8.htm>.

exemption must not be the key factor behind the CIC's decision not to increase its holding of Moran Stanley. The CIC's choice of not proceeding with the transaction might come as a result of comprehensive consideration and business calculation. Moreover, asking for a guaranteed fixed annual profit of 9% when the CIC invested in Morgan Stanley in 2007, showed where the CIC allocated the risk in the first place. Whether and when the CIC will choose to become a financial holding company in the U.S. is a question worth further attention.

VII. CONCLUSION: HOW TO BE BETTER RECEIVED

It has been more than thirty years since China adopted the policies of reform and opening to the outside world, and China has made great progress in almost all respects. During the thirty-two years since China established diplomatic relations with the U.S., it can be concluded that mutual benefit can only arise from constructive coordination. By utilizing foreign investment, companies like the CIC become more and more active in overseas investment. During the process of development, problems and controversies may arise. But as President Hu Jintao illuminated in Dec. 2008 when met with Henry M. Paulson, then the U.S. Secretary of the Treasury, that China will join hands with the U.S. to boost exchanges and communication, expand strategic mutual trust and appropriately handle sensitive issues in an effort to step up bilateral constructive and cooperative relations. At the same meeting, Mr. Paulson responded that the U.S.-China relationship is one of the most important mutual relationships in the world, that developing U.S.-China coordination is in the interest of both countries, and that the U.S. strives to make a joint effort with China.⁶³ The U.S. welcomed the Chinese SWF and foreign exchange reserve making commercially based investments in America.⁶⁴ In earlier talks, Vice-Premier Wang Qishan specifically mentioned that China hopes that

⁶³ 陈一鸣, 胡锦涛会见保尔森, 人民日报海外版, Chen Yiming, *Hu Jintao's Meeting with Henry M. Paulson Jr., the Secretary of the Treasury of the U.S.*, PEOPLE'S DAILY OVERSEAS EDITION, Dec. 6, 2008, at 1.

⁶⁴ Li Yanping & Rebecca Christie, *U.S. to Speed Investment from China Banks, State Fund*, BLOOMBERG, Dec. 5, 2008, <http://www.bloomberg.com/apps/news?pid=20601103&sid=aa1jOhH.t0sU&refer=news>.

the U.S. will take all necessary measures in stabilizing the economy and financial markets to ensure the safety of Chinese assets and investments in America.⁶⁵

It can be conceived that in building the “constructively coordinated relationship,” China and the U.S. may have different understandings and expectations.⁶⁶ For example, the President of the CIC Gao’s commitment to make the CIC as transparent as Norway’s SWF cannot fully expel U.S. doubts. Distinguished American economist Lawrence Summers, who made an appearance in the same CBS 60 Minutes program, expressed his concern on this issue. Another economist Peter Navarro, pointed directly to the fact that the CIC’s investment and American public debt holding by China pose a financial nuclear threat against the U.S.⁶⁷ Even though there has not been any evidence indicating that SWFs are politically based investments or any precedent of SWFs harming national security interests in the past fifty years, Summers and Hillary Clinton have been advocating the establishment of a code of conduct for SWFs.⁶⁸

Investment in the U.S. is an epitome of the CIC’s overseas investment. At present, many countries are hoping for capital support from China, but meanwhile are harboring doubts against it. The International Working Group of Sovereign Wealth Funds under the International Monetary Fund (IMF) published the Generally Accepted Principles and Practices (GAPP) for SWFs, as a step towards improving the understanding of SWFs’ current practices. The twenty-four voluntary principles cover areas of legal framework, objectives and macroeconomic linkages, institutional frameworks, governance structures, investment policies, and risk management.⁶⁹

⁶⁵ Andrew Batson, *U.S., China Pledge Joint Fiscal Support*, WALL ST. J., Dec. 6, 2008, at A7, available at <http://online.wsj.com/article/SB122846732843782573.html>; accord Miles Weiss & Belinda Cao, *China’s CIC May Have \$5.4 Billion Frozen in Money-Market Funds*, BLOOMBERG, Oct. 12, 2008, <http://www.bloomberg.com/apps/news?pid=20602002&sid=ancX7qXx0kXk&refer=markets> (controversy over the CIC’s investment in the U.S. Reserve Primary Fund).

⁶⁶ Andrew Jacobs, *Paulson’s China Trip Leaves Big Issues Unresolved*, N.Y. TIMES, Dec. 6, 2008, at B3, available at <http://www.nytimes.com/2008/12/06/business/worldbusiness/06paulson.html?ref=asia>.

⁶⁷ See *China Investment An Open Book?*, *supra* note 27.

⁶⁸ See Lawrence Summers, *Funds that Shake Capitalist Logic*, FIN. TIMES (U.K.), July 30, 2007, at 11, available at <http://blogs.ft.com/economistsforum/2007/07/sovereign-funds.html>. Summers has been appointed as the Chairman of National Economic Council, while Clinton took up the post of Secretary of the State. They are both highly conscious about SWFs.

⁶⁹ SOVEREIGN WEALTH FUND, IMF’S PROPOSED SOVEREIGN WEALTH FUNDS, GENERALLY ACCEPTED PRINCIPLES AND PRACTICES: SANTIAGO PRINCIPLES (2008), available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>, (last visited Feb. 8, 2010).

The European Union (EU) and the Organization for Economic Cooperation and Development (OECD) have been establishing applicable codes in an effort to coordinate attitudes towards SWFs.⁷⁰ It is understandable that every country holds various opinions in this field.⁷¹ As a member of a country possessing a SWF, China is member of the Working Group of the IMF, and Chairman Lou Jiwei also attended a dialogue with the EU.

Openness and transparency should not only be adopted in foreign relations, but also in domestic affairs. Despite the CIC's efforts in making itself more advanced in the field, domestic public understanding towards the CIC is largely limited to the few pages on its website, and the public legal demonstration of Huijin can only be elusively captured in the prospectuses of the banks it controls.⁷² Technically speaking, the capital of the CIC is funded through issuing special treasury bonds. With the approval of the Standing Committee of the 10th National People's Congress, the Ministry of Finance of China issued RMB 1.55 trillion worth of special treasury bonds and used the funds to raise to purchase foreign exchange reserves (worth USD 200 billion), which was then injected into the CIC as its registered equity capital. Therefore, the CIC has to pay dividends to the State Council as its owner, to cover the cost of these special treasury bonds.

The abovementioned IMF GAPP, though signed voluntarily, has received unanimous acknowledgement among its members. Those principles included the following aspects:

- The legal framework for SWFs should be sound.
- The key features of the SWFs' legal basis and structure, as well as the legal relationship between the SWFs and the other state bodies, should be publicly disclosed.

⁷⁰ Press Release, Commission puts forward proposals to the European Council on sovereign wealth funds and financial stability, European Commission (Feb. 27, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/313&format=HTML&aged=0&language=EN&guiLanguage=en> (last visited May 28, 2010).

⁷¹ IMF's Proposed Sovereign Wealth Fund Code Ruffles Feathers, BRETTON WOODS PROJECT, Feb. 1, 2008, <http://www.brettonwoodsproject.org/art-559988> (last visited Feb. 8, 2010) [hereinafter *Code Ruffles Feathers*].

⁷² 与发起人的关系及关联交易, Yu fa qi ren de guan xi ji guan lian jiao yi [Relationships with Charter Members and Related Transactions], http://www.hkexnews.hk/listedco/listconews/sehk/20061016/01398/CWP117_c.pdf, (Last visited Feb. 8, 2010).

- The SWFs' policies, rules, procedures, or arrangements in relation to the SWFs' general approach to funding, withdrawal, and spending operations should be disclosed.
- The relevant statistical data pertaining to SWFs should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.
- The accountability framework for the SWFs' operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.
- An annual report and accompanying financial statements on the SWFs' operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.
- The SWFs' operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.
- The governance framework and objectives, as well as the manner in which the SWFs' management is operationally independent from the owner, should be publicly disclosed.
- Relevant financial information regarding SWFs should be publicly disclosed.
- SWFs' operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.
- The assets and investment performance (absolute and relative to benchmarks, if any) of SWFs should be measured and reported to the owner according to clearly defined principles or standards.⁷³

When judged by the principles above, the legal, operational, and disclosure frameworks of the CIC are all obviously inadequate. The foreign exchange assets utilized by the CIC came from the national foreign exchange reserve, and it is essentially a special form of the

⁷³ IMF's *Proposed Sovereign Wealth Fund Code Ruffles Feathers*, *supra* note 72.

central government's debt financing. Therefore, the CIC should receive further attention, support, as well as scrutiny and supervision from Chinese citizens in particular.