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**Remarks at the Natioanl University of Singapore Risk Management Conference**
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## Introduction

I want to thank you for inviting me to participate in the National University of Singapore Conference on Risk Management.

Although sovereign wealth funds have been the focus of intense interest recently, they are hardly a new phenomenon. The oldest may be the Kuwait Investment Board, established in 1953 to invest surplus oil revenue. Here in Singapore, Temasek was established in 1974, and the Government Investment Corporation (GIC) was set up in 1981. By the year 2000, there were about 20 sovereign wealth funds worldwide managing total assets of several hundred billion dollars.

What has changed is the rapid increase in both the number and size of sovereign wealth funds. About twenty new funds have been created since 2000, and more than half of these since 2005, which brings the total number to nearly 40 funds that now manage total assets in a range of $2-3 trillion. This rapid growth is expected to continue. Private analysts project that sovereign wealth fund assets could grow to $10-15 trillion by 2015. Two trends have contributed to this growth. The first is sustained high commodity prices. The second is the accumulation of official reserves and the transfers from official reserves to investment funds in non-commodity exporters.

Twenty years ago, ten years ago, even five years ago, sovereign wealth funds were relatively small, government-owned, and very few people knew they existed. Today sovereign wealth funds are large, government-owned, and growing rapidly. A great many people know of them, but very few know who they are, how they are organized and operate, and what their objectives are. But they are an important part of the global market, and the international community must work toward the smooth integration of sovereign wealth funds into the international financial system. We at Treasury have been helping to craft a multilateral response to the issues raised by these funds. Our primary objective has been and will continue to be to ensure an open and stable international financial system.

I will be talking about sovereign wealth funds from a public policy perspective, examining the issues that they raise. These include the potential impact sovereign wealth funds could have on international financial markets – either as a result of what they do, or what other markets participants perceive they have done or will do and the potential for a protectionist backlash to SWF investment – which would deprive recipient countries of the benefits of foreign investment and cut off access to profitable investment and diversification opportunities for SWFs.

## Financial System Stability

As many observers have recognized, sovereign wealth funds have the potential to promote financial stability. They generally have a good track record as stable, long-term investors that

provide significant capital to the system. Their long-term investment horizon should enable them to maintain their strategic asset allocations amid periods of short-term volatility. Sovereign wealth funds typically do not use leverage, nor do they have capital requirements that could force them to liquidate positions rapidly. Sovereign wealth funds often invest through well-regarded private fund managers and custodians.

But the increasing number and size of sovereign wealth funds do have implications for financial market stability. Sovereign wealth funds represent large, concentrated, and often non-transparent positions in financial markets, with the potential to move markets. Actual shifts in their asset allocations can cause price volatility. Even rumors of shifts may cause market participants to react to what they perceive sovereign wealth funds to be doing.

As I will discuss a little later in my remarks, the work of the IMF to develop best practices for sovereign wealth fund governance, institutional and risk management arrangements, investment policies, and transparency will be critical to addressing financial system stability concerns.

## Open Investment Regimes

Most of the attention to sovereign wealth funds has come in the area of investment policy. Rapid growth of these funds has come at a time of increasing scrutiny of foreign investment, and increasing protectionist threats to open investment regimes.

In this area, the policies of the Bush Administration are clear. We stand for open investment. As President Bush said in his May 2007 Statement on Open Economies, "a free and open international investment regime is vital for a stable and growing economy, both in the United States and throughout the world." International investment in the United States fuels our prosperity by creating well-paying jobs, bringing new technology and business methods, and providing healthy competition that fosters innovation, productivity gains, lower prices, and greater variety for consumers. In 2006, foreign-owned firms contributed almost six percent of U.S. output and 14 percent of U.S. R&D spending. U.S. affiliates of foreign-owned firms employ over five million Americans, paying on average more than 25 percent higher compensation than the U.S. private sector average. A similar number of additional jobs are indirectly supported by these firms' U.S. operations. Recognizing the benefits of international investment, the United States continues to welcome such investment, including investment by sovereign wealth funds.

It is important that countries that receive foreign investment take actions that create and maintain open investment regimes. I will describe some of the efforts that we are taking in that regard. At the same time, sovereign wealth funds do raise investment issues, and they have a role – and an interest – is assuring that open investment policies are maintained. There are two sets of issues to consider.

First, transactions involving investment by sovereign wealth funds, as with other types of foreign investment, may raise legitimate national security concerns. At the same time, national security should not be used as an excuse for pursuit of protectionist policies, industrial policy, or the

creation of national champions. Countries that receive sovereign wealth fund investment need to ensure that national security concerns are addressed, without unnecessarily limiting the benefits of an open economy. The U.S. experience with the Committee on Foreign Investment in the United States, known as CFIUS, shows that it is possible to safeguard national security while continuing to welcome foreign investment. CFIUS, which Treasury chairs, reviews foreign direct investments that result in foreign control of U.S. businesses and which may raise national security considerations. Since CFIUS began reviews in 1988, its caseload has included numerous foreign government-controlled investments, including by sovereign wealth funds.

Second, sovereign wealth funds raise a number of **non**-national security investment issues related to potential distortions from a larger role of foreign governments in markets. For example, through inefficient allocation of capital, perceived unfair competition with private firms, or the pursuit of broader strategic rather than strictly economic return-oriented investments, sovereign wealth funds could potentially distort markets. A particular example that is likely to raise concerns about unfair competition is if sovereign wealth funds pool their resources with domestic state-owned or private enterprises in making an overseas investment.

The investment policy issues I have just described – both the national security and non-national security issues – have the potential to provoke protectionist responses from recipient country governments. It is my view that protectionist sentiment stems partly from a lack of information and understanding of sovereign wealth funds, which in turn is partly due to a lack of transparency and clear communication on the part of many of the funds themselves. Further, concerns about cross-border investment by state-owned enterprises are often misdirected at sovereign wealth funds as a group. Better information and understanding on both sides of the investment relationship is therefore needed.

Towards Best Practices for Sovereign Wealth Funds and Recipient Countries

The Department of the Treasury has been actively involved, along with sovereign wealth funds, major recipient countries, and international institutions, in shaping an appropriate international policy response to the financial market and investment issues raised by sovereign wealth funds. Our efforts are based on the belief that both sovereign wealth funds and the countries in which they invest have a strong stake in ensuring a stable and open international financial system.

The approach for sovereign wealth funds is to encourage the formulation and adoption of best practices to mitigate potential systemic risks and help demonstrate to critics that SWFs will continue to be responsible, constructive participants in the international financial system.

We have worked closely with major sovereign wealth funds on principles as well as practices. Our discussions with Abu Dhabi and Singapore resulted in agreement on the following five policy principles, announced in a joint statement at Treasury on March 20:

1. SWF investment decisions should be based solely on commercial grounds, rather than to advance, directly or indirectly, the geopolitical goals of the controlling government.

SWFs should make this statement formally as part of their basic investment management policies.
2. Greater information disclosure by SWFs, in areas such as purpose, investment objectives, institutional arrangements, and financial information – particularly asset allocation, benchmarks, and rates of return over appropriate historical periods – can help reduce uncertainty in financial markets and build trust in recipient countries.
3. SWFs should have in place strong governance structures, internal controls, and operational and risk management systems.
4. SWFs and the private sector should compete fairly.
5. SWFs should respect host-country rules by complying with all applicable regulatory and disclosure requirements of the countries in which they invest.

These principles will help inform the international dialogue on the issues raised by sovereign wealth funds. The principles also provide a framework for thinking about what we believe is the most appropriate international response to these issues: multilaterally-agreed best practices for sovereign wealth funds.

Last year, the United States proposed, along with other nations, that the IMF identify a set of voluntary best practices for sovereign wealth funds. This work is now underway in the Fund. On March 21, the IMF Executive Board endorsed a work agenda to develop best practices in governance, institutional and risk management arrangements, investment policies, and transparency. That work agenda, published by the IMF and available on their website, is not simply addressed to the issues that I have identified, but addresses many issues of intrinsic importance to sovereign funds, including how manage and reduce operational, financial, and reputational risks.[1] On April 30, an International Working Group of sovereign wealth funds (IWG) was established at a meeting hosted by the IMF in Washington. The IWG will prepare a first draft of best practices by the IMF Annual Meetings in October.

Some observers have questioned the logic of voluntary best practices. They argue sovereign wealth funds do not have adequate incentives to adopt best practices, and that a tough enforcement mechanism is needed. This misses the point that the intent behind identifying best practices for sovereign wealth funds is to create a dynamic rise to the top that renders unnecessary such regulation, which could become draconian and stifle an important source of economic growth. A set of best practices will create a natural incentive among funds to hold themselves to high standards. Sovereign wealth funds themselves are increasingly aware that the increase in the number and size of these funds has, rightly or wrongly, raised reputational issues for them all.

We understand that investment is a two-way street. Treasury is encouraging the Organization for Economic Cooperation and Development to identify investment policy best practices for countries that receive foreign government-controlled investment, including investment from sovereign wealth funds. This effort would complement the extensive work already underway at the OECD on open investment and national security.

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[1] IMF, "Sovereign Wealth Funds—A Work Agenda," Feb 29, 2008, http://www.imf.org/external/np/pp/eng/2008/022908.pdf

Investment policy best practices should focus on avoiding protectionism, and should be guided by the well-established principles of proportionality, transparency, predictability and accountability embraced by the OECD and its members for the treatment of foreign investment. In our statement with Singapore and Abu Dhabi, we have suggested the following principles for investment recipients:

1. Countries receiving SWF investment should not erect protectionist barriers to portfolio or foreign direct investment.

2. Recipient countries should ensure predictable investment frameworks. Inward investment rules should be publicly available, clearly articulated, predictable, and supported by strong and consistent rule of law.

3. Recipient countries should not discriminate among investors. Inward investment policies should treat like-situated investors equally.

4. Recipient countries should respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment. Any restrictions imposed on investments for national security reasons should be proportional to genuine national security risks raised by the transaction.

As interim steps, the OECD Investment Committee produced a paper in April on "Sovereign Wealth Funds and Recipient Country Policies," and the OECD issued a declaration regarding inward investment policy principles and SWFs at its June Ministerial. We hope the final results will serve as a touchstone to guide countries that receive sovereign investments.

The multilateral development of best practices for sovereign wealth funds and for recipient countries will be important in ensuring the smooth incorporation of sovereign wealth funds into the global financial system, and in avoiding market uncertainty or protectionist reaction to the growing investment profile of sovereign wealth funds. We have been pleased by the leadership on the issues that we have seen from some funds and their governments, notably, Singapore's early endorsement of the effort to develop best practices.

There are also steps that individual SWFs and their home governments can take to increase public understanding and support, reduce uncertainty, and help ensure that their investments are welcome. The exemplary transparency and reporting to Parliament of the Korea Investment Corporation (KIC), and the extensive work done in Korea to build a broad consensus for the creation and operation of KIC is one example. So are visits by the China Investment Corporation to potential recipient countries, their willingness to meet with the press, and their willingness to sit down and discuss their plans with their critics. Actions like these will help build the kind of market comfort with sovereign wealth funds that now exists with pension funds, university endowments, or other large institutional investors.

Conclusion

Sovereign wealth funds are already an important part of global capital markets, and will become even more prominent in the years to come. We all have an interest in the smooth integration of these funds in an open and stable international financial system. The multilateral effort to develop a code of best practices for sovereign wealth funds is the most effective way of bringing this about.

Thank you.