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THE RISE AND U.S. INVASION OF SOVEREIGN WEALTH FUNDS: A GROWING SOURCE OF CONCERN

Sovereign wealth funds have already invested billions in western institutions, but their lack of transparency has heightened political, economic, and national security concerns. While Congress explores the issues, U.S. managers for such funds need to consider domestic and home country regulation of collective investment vehicles and reporting obligations triggered by significant positions.

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As of April, 2008, U.S. and global financial institutions have reported upwards of \$200 billion in write-downs from investments in credit-linked instruments, especially those tied directly or indirectly to the U.S. mortgage market.¹ As losses have mounted, several Wall Street

financial institutions have been brought to the brink of extinction, leaving such firms searching for a lifeline or cash infusion from any and all sources. One such source has been sovereign wealth funds, which are essentially government-owned investment vehicles. Indeed, huge investments in western companies by Asian and Middle Eastern sovereign wealth funds, including from the Abu Dhabi Investment Authority and the Government of Singapore, have come to the aid of those investment firms hardest hit by the “credit crunch,” including Citigroup, Inc., Merrill Lynch & Co., and UBS AG.²

Currently, assets under management for sovereign wealth funds are estimated to be between \$1.9 and \$3.5

¹ Bear Stearns, Credit Suisse, Citigroup, UBS, Morgan Stanley, Merrill Lynch, Bank of America, and HSBC have all reported substantial losses. See Susanne Fowler, *Credit Suisse Predicts First Loss Since 2003*, N.Y. TIMES, Mar. 21, 2008; Chris Reiter, *JPMorgan Offers Bear Stearns Staff Bonuses*, REUTERS, Mar. 20, 2008; Jenny Anderson & Eric Dash, *Citigroup’s Big Loss Fuels Anxiety and Depresses Stocks*, N.Y. TIMES, Jan. 16, 2008; Landon Thomas, Jr., *\$9.4 Billion Write-Down at Morgan Stanley*, N.Y. TIMES, Dec. 20, 2007 (stating that worst case scenarios estimate an eventual loss of \$200 billion or more); Julia Werdigier & Landon Thomas, Jr., *HSBC Takes \$3.4 Billion Charge*, N.Y. TIMES, Nov. 15, 2007; and Graham Bowley & Jenny Anderson, *Where Did the Buck Stop at Merrill?*, N.Y. TIMES, Nov. 4, 2007.

² MARTIN A. WEISS, SOVEREIGN WEALTH FUNDS: BACKGROUND AND POLICY ISSUES FOR CONGRESS, (Congressional Research Service) (Jan. 31, 2008) at 3-4 [hereinafter *CRS Report*], available at http://assets.opencrs.com/rpts/RL34336_20080131.pdf.

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trillion.³ In the 4th Quarter of 2007, sovereign wealth funds had invested approximately \$44.5 billion in Western financial institutions alone.⁴ As sovereign wealth funds continue to grow and diversify their underlying investments, concerns have mounted over the lack of transparency regarding their investment objectives and strategies, and possible non-economic or political influence on U.S. institutions.⁵ Congress, the U.S. Department of Treasury, and international organizations, including the International Monetary Fund (IMF) and the Organisation for Economic Co-Operation and Development (OECD), are currently assessing the benefits and risks of sovereign wealth funds and their impact on world financial markets. This article seeks to: (i) provide an overview of sovereign wealth funds; (ii) outline the concerns related to their investment in U.S. financial institutions; and (iii) discuss potential U.S. policy and regulatory responses to these concerns. In addition, this article will conclude by highlighting several legal issues to consider when marketing to, or managing money for, sovereign wealth funds.

OVERVIEW

There is no single agreed upon definition of a sovereign wealth fund. Generally, it is a separate pool of assets owned by a government and managed separately from official reserves to achieve economic and/or financial objectives (e.g., fiscal revenue stabilization,

asset diversification, or performance returns). The first sovereign wealth fund was established by the Pacific island nation of Kiribati in 1956 to manage phosphate deposit revenues.⁶ By the year 2005, there were approximately 40 sovereign wealth funds in existence representing various countries, including China, Japan, Singapore, United Arab Emirates, and Russia.⁷ As shown in the chart contained in Appendix I on page 160, the largest sovereign wealth funds (in terms of both assets under management and number) are sponsored in the Middle East and Asia, respectively.

Sovereign wealth funds typically do not include national pension funds or central banks.⁸ Many sovereign wealth funds derive their funding from natural resources (e.g., oil) and are known as commodity sovereign wealth funds.⁹ Others consist of revenues from privatization and foreign exchange reserves and are commonly known as non-commodity sovereign wealth funds.¹⁰ Regardless of their origins, sovereign wealth funds continue to grow at an extraordinary pace as the world undergoes a massive redistribution of wealth. By 2015, sovereign wealth fund assets are forecasted to

³ *Id.* at 1. See also, PREQIN SOVEREIGN WEALTH FUND REVIEW: ACTIVITY IN PRIVATE EQUITY AND PRIVATE REAL ESTATE (Private Equity Intelligence Ltd) (2008) at 7 [hereinafter *Preqin Report*]. Note that figures on total assets under management will differ depending on how a source defines a sovereign wealth fund.

⁴ *Id.* at 3.

⁵ *Sovereign Wealth Fund Acquisitions and Other Government Investments in the United States: Assessing the Economic and National Security Implications: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong. (2007) [hereinafter *Senate Hearing*].

⁶ *Id.* (statements of Edwin M. Truman, Senior Fellow, Petersen Institute for International Economics and David H. McCormick, U.S. Treasury Under Secretary for International Affairs).

⁷ *Id.* See also, GERARD LYONS, STATE CAPITALISM: THE RISE OF SOVEREIGN WEALTH FUNDS (Standard Chartered Bank) (Nov. 14, 2007) [hereinafter *Standard Chartered Report*].

⁸ *Standard Chartered Report*, *supra* note 7 at 23.

⁹ *Standard Chartered Report*, *supra* note 7 at 32-62. See also, Robert M. Kimmitt, Deputy Secretary of the U.S. Department of the Treasury, *Public Footprints in Private Markets – Sovereign Wealth Funds and the World Economy*, FOREIGN AFFAIRS, Feb. 2008 [hereinafter *Kimmitt Article*].

¹⁰ *Standard Chartered Report*, *supra* note 7 at 32-62. See also, *Senate Hearing*, *supra* note 5 (statement of Edwin M. Truman) (listing 32 sovereign wealth funds and their source of funds; for example, the Korea Investment Corporation was established in 2005 and funded with foreign exchange reserves, and Malaysia's Khazanah Nasional Berhad fund was established in 1993 with fiscal surpluses).

reach approximately \$10 to \$15 trillion.¹¹ What these figures suggest is that sovereign wealth funds will have an impact on the world economy. The question is – how? Little is known about their activities, including their investment objectives.

STRUCTURE, MANAGEMENT, AND INVESTMENT POLICY

There is very little transparency with respect to the activities or organizational structure of sovereign wealth funds. Public information on the structure utilized by various sovereign wealth funds for investment purposes is scarce. Some sovereign wealth funds have operated in the form of a separate account, while others have been established as trusts. For example, the Australian Future Fund was established as a “special account”¹² created by the Australian Finance Minister by way of a government act,¹³ while the Alaska Permanent Reserve Fund (APRF) was initially created as an investment savings account¹⁴ and then established as a public trust.¹⁵

Management responsibility for a sovereign wealth fund varies from finance ministries, central banks, and executive boards to external money managers.¹⁶ Unlike

mutual funds and pension funds, sovereign wealth funds typically do not have external investors who may withdraw capital on short notice. Accordingly, sovereign wealth funds have the ability to take higher levels of risk than many traditional investors.¹⁷

Sovereign wealth funds invest in an array of assets, including equity, fixed income, real estate, bank deposits, and alternative investments.¹⁸ They may invest in foreign and, sometimes, domestic assets.¹⁹ Investment may be long-term and passive in nature.²⁰ Some sovereign wealth funds, however, operate akin to private equity vehicles and purchase varying investment interests directly and, arguably, for control purposes. Sovereign wealth funds also have invested directly in U.S. financial institutions (*e.g.*, Merrill Lynch and Citigroup).²¹ These direct investments, as well as the influence sovereign wealth funds may have on the U.S. economy, have picqued the attention of the U.S. government.

POLITICAL, ECONOMIC, AND NATIONAL SECURITY CONCERNS

Investment in the U.S. economy by sovereign wealth funds provides a necessary influx of capital in certain scenarios. However, there is a concern that a sovereign wealth fund and its government sponsor could control the U.S. company in which the sovereign wealth fund

¹¹ *The New Power Brokers: How Oil, Asia, Hedge Funds, and Private Equity Are Shaping Global Capital Markets* (McKinsey & Company), Oct. 2007 [hereinafter *McKinsey Report*]; *Currencies: How Big Could Sovereign Wealth Funds Be by 2015* (Morgan Stanley Research Global) (May 3, 2007); *Standard Chartered Report, supra* note 7 (explaining that the future growth of sovereign wealth fund assets is a result of a number of factors, including the petrodollars and revenues generated by the recent boom in commodity prices, growth in foreign exchange reserves, the investment performance and returns achieved by sovereign wealth funds, and type and amount of future government funding); and LEE HUDSON TESLIK, SOVEREIGN WEALTH FUNDS (Council on Foreign Relations) (Jan. 18, 2008).

¹² Future Fund Act 2006, available at <http://www.comlaw.gov.au>.

¹³ Financial Management and Accountability Act of 1997, available at <http://www.comlaw.gov.au>.

¹⁴ Alaska Permanent Fund Corporation, Annual Report (2007).

¹⁵ Alaska Permanent Fund Corporation, Fund History, available at <http://www.apfc.org/reportspublications/pfhistory.cfm> (last visited Feb. 5, 2008).

¹⁶ See *e.g.*, Alaska Permanent Fund Corporation, Annual Report (2007). For example, the APRF is managed by the APFC and its board of trustees, which allocates investment management responsibility to a number of external managers, including T Rowe Price, Dodge & Cox, and UBS Global Asset

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Management. See also, *Standard Chartered Report, supra* note 7.

¹⁷ *Standard Chartered Report, supra* note 7 at 60.

¹⁸ *Standard Chartered Report, supra* note 7 (describing a number of sovereign wealth funds, their investment policies and asset allocations) and EDWIN M. TRUMAN, SOVEREIGN WEALTH FUNDS: THE NEED FOR GREATER TRANSPARENCY AND ACCOUNTABILITY (Petersen Institute for International Economics) (Aug. 2007). See also, *CRS Report, supra* note 2 at 2, citing to STEPHEN JEN, ECONOMICS: HOW MUCH ASSETS COULD SOVEREIGN WEALTH FUNDS FARM OUT? (Morgan Stanley Global Research) (Jan. 10, 2008).

¹⁹ *Standard Chartered Report, supra* note 7.

²⁰ *McKinsey Report, supra* note 11 at 17 and 49 (describing oil funded sovereign wealth funds) and *Kimmitt Article, supra* note 9 at 2.

²¹ These entities have suffered financially in connection with the U.S. credit crisis. Also, the China Investment Corporation invested \$3 billion to acquire almost 10% of the initial public stock offering of the U.S. investment fund Blackstone Group LP.

has invested for political or other non-economic purposes. To address concerns on foreign direct investment, Congress enacted the Foreign Investment and National Security Act of 2007 (FINSA).²² FINSA provides for the Committee on Foreign Investment in the United States (CFIUS)²³ to review certain foreign direct investments that may result in a non-U.S. entity exercising control over a U.S. entity.²⁴ An extended CFIUS review may occur for transactions where a foreign entity exercising control over a U.S. company could affect U.S. national security.²⁵ While FINSA was a first step in addressing some of the concerns on foreign direct investment, direct investment by sovereign wealth funds located in Russia, China, and other foreign countries in U.S. companies raises additional concerns regardless of whether the sovereign wealth fund is controlling the U.S. company for definitional purposes.

Accordingly, policy makers and others are apprehensive regarding foreign ownership of strategic U.S. businesses. In November 2007, the Senate Committee on Banking, Housing, and Urban Affairs held a hearing to explore the growth of sovereign wealth funds and the attendant unease with such vehicles. Those speaking at the Senate hearing noted several benefits of sovereign wealth fund investment in the U.S. (e.g., capital infusion, corporate bailouts, and job creation). They also outlined a number of issues surrounding their investment in the U.S., including the following:

- **Foreign Economic Control for Political or other Motives** - foreign governments using their economic control over a U.S. entity through a sovereign wealth fund for foreign political interests rather than profit maximization;²⁶

²² U.S. Public Law 110-49.

²³ *Id.* CFIUS is a multi-agency committee created in 1975 by President Ford and expanded in 1988 by President Reagan, and is now comprised of the following members or their designee: Secretaries of State, Treasury, Homeland Security, Commerce, Defense, and Energy, the Attorney General of the United States, and the Director of the National Intelligence.

²⁴ *Id.*

²⁵ *Id.* On April 21, 2008, the Treasury proposed regulations for the implementation of FINSA. The proposal indicates that sovereign wealth funds that involve ownership under 10% of a U.S. entity would not be exempt from an extended review.

²⁶ *Senate Hearing, supra* note 5. *See also, McKinsey Report, supra* note 11 (stating that “some sovereign wealth funds in oil-exporting regions have signaled their intention to shift from

- **Investment Protectionism** - potential host countries of sovereign wealth fund investments adopting a protectionist stance and rejecting legitimate investments, which could damage the free flow of capital and global investment; and
- **Financial Instability** - a foreign government mismanaging its international investments with negative consequences for the global economic and financial system.

Those testifying urged the Senate Committee to reject a protectionist stance against sovereign wealth funds and consider, instead, supporting a framework that would provide greater transparency aimed at alleviating the above concerns. The U.S. Treasury’s Undersecretary for International Affairs has echoed these sentiments and recommended that OECD identify best practices for countries that receive foreign government-controlled investment. Others have advocated the creation of sovereign wealth fund best practices and progress has been made in this area.²⁷

Carrying the cause for increased transparency, Senator Charles E. Schumer (D-NY) convened a hearing before the Joint Economic Committee (JEC Hearing) to examine increased investment by sovereign wealth funds.²⁸ Like the November Senate Hearing, those

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being largely passive investors to taking larger equity stakes in foreign companies”). *See also*, Brian G. Cartwright, General Counsel of the U.S. Securities and Exchange Commission, Address at University of Pennsylvania Law School Institute for Law and Economics, Oct. 24, 2007 (stating that it is a potential problem for a foreign government through a sovereign wealth fund to own or seek a significant position in a major U.S. based private equity firm, a leading proxy voting advisory firm, or a U.S. securities exchange); The State of the Securities Markets: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs, 110 Sess. (2007) (statement of Christopher Cox, Chairman of the U. S. Securities and Exchange Commission) (suggesting the use of professional managers for sovereign wealth funds to help depoliticize investment decisions).

²⁷ For example, in October 2007 Treasury Secretary Paulson hosted a G-7 outreach dinner with Finance Ministers and heads of sovereign wealth funds from eight countries (China, Korea, Kuwait, Norway, Russia, Saudi Arabia, Singapore, and the United Arab Emirates) to build support for sovereign wealth fund best practices. Also in November 2007 the IMF hosted a roundtable meeting for sovereign asset and reserve managers.

²⁸ *Do Sovereign Wealth Funds Make the U.S. Economy Stronger or Pose National Security Risks: Hearing Before the Joint Economic Committee*, 110th Cong. (2008) [(hereinafter *JEC*

speaking before the JEC supported sovereign wealth fund investment in the U.S.²⁹ and advocated a balanced and “wait and see” approach with respect to oversight (government or otherwise) of sovereign wealth fund investment here. There was a consensus supporting the position that Congress should not act unilaterally to prohibit sovereign wealth fund investment in the U.S. because such investments affect multiple jurisdictions; the speakers advocated, instead, a multilateral approach to sovereign wealth fund investment. In addition, there was a consensus that Congress should continue to support and monitor non-governmental efforts by the IMF and OECD to increase transparency of sovereign wealth fund investment objectives and governing structure, but *not* to seek legislation or pressure regulators to impose heavy regulation on sovereign wealth funds.³⁰

Like the U.S., other jurisdictions are also reviewing and enacting policies to regulate foreign investment to protect national security interests.³¹ Countries take differing approaches, from requiring a formal review process for transactions related to investments in entities that are vital to national security (*e.g.*, defense industrial

base, energy sector), to mandatory review of an investment that reaches a certain dollar threshold or seeks to control the investee company.³² Other countries do not have a formal review process, but require some level of reporting.³³

THE VIEWS OF THE SEC

The SEC also is monitoring the rise of sovereign wealth fund investment in the U.S. and has identified additional attendant areas of concern from a securities regulation perspective.³⁴ For example, sovereign wealth funds could operate with information not available to retail and private institutional investors, and confidence in the U.S. market could collapse if investors believe that they are at an informational disadvantage with respect to a foreign-controlled sovereign wealth fund. Additionally, a foreign government controlling a company under SEC investigation could end its cooperative relationship with the SEC and stymie the SEC’s ability to enforce U.S. federal securities laws against the company and/or the foreign government. To address these and other concerns, the SEC supports open markets and rejects a protectionist position toward sovereign wealth fund investment in the U.S.³⁵ The SEC recommends further consideration of the matter and increased transparency of the operations and investments of sovereign wealth funds.³⁶ While further consideration of the issue is necessary, it should not be overlooked that sovereign wealth funds may have existing reporting obligations under both U.S. federal and state law.

TRANSPARENCY AND EXCHANGE ACT REPORTING

There are a number of provisions under the Securities Exchange Act of 1934 and other federal securities laws

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Hearing]. See also, Maria Bartiromo, *Chuck Schumer on the Rise of Sovereign Wealth Funds*, BUSINESSWEEK, Mar. 17, 2008. See also, *Turmoil in U.S. Credit Markets: Examining the U.S. Regulatory Framework for Assessing Sovereign Investments*, 110th Cong. (2008) (continuing the consideration of sovereign wealth fund investment in the U.S., and current and potential oversight of such investment).

²⁹ *Id.* (statement of Stuart Eizenstat, Partner and Chair of the International Practice Group, Covington & Burling LLP) (noting that sovereign wealth funds “bolster the U.S. economy and are a significant net plus for the U.S. economy”).

³⁰ *Id.* (advocating that Congress (i) allow the IMF and OECD, each of which are currently examining sovereign wealth funds, to develop guidance in the form of best practices/principles and (ii) monitor how sovereign wealth funds react to such efforts).

See also, *JEC Hearing*, *supra* note 28 (testimony of Douglas Rediker, Co-Director Global Strategic Finance Initiative, The New America Foundation) (urging Congress to continue supporting efforts to increase disclosure and transparency regarding sovereign wealth fund investment guidelines, currency composition, and geographic diversification).

³¹ In February 2008, the GAO published a report describing selected countries’ (i) laws and policies enacted to regulate foreign investment to protect their national security interests and (ii) implementation of those laws. See, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, FOREIGN INVESTMENT - LAWS AND POLICIES REGULATING FOREIGN INVESTMENT IN 10 COUNTRIES, (Government Accounting Office) (Feb. 2008).

³² *Id.*

³³ *Id.*

³⁴ Christopher Cox, Chairman of the U.S. Securities and Exchange Commission, Gauer Distinguished Lecture in Law and Policy at the American Enterprise Institute Legal Center for the Public Interest, Dec. 5, 2007.

³⁵ *Id.*

³⁶ *Id.* See also, Ethiopis Tafara, Director, Office of International Affairs of the U.S. Securities and Exchange Commission, Testimony Before the Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, and the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises (Mar. 5, 2008).

that require reporting and that may apply to the investment of sovereign wealth funds in U.S. companies. These include:

Section 16(a) and Form 3. Form 3 under Section 16(a) of the Exchange Act requires that an issuer's officers and directors, as well as any beneficial owner holding 10% or more of an issuer's equity securities, disclose their ownership interest. This disclosure requirement is designed to provide the marketplace with information about the purchase and sale of issuer securities by individuals and entities who may be exposed to important information about a public company.

Section 13(d) and Form 13-D. Beneficial owners of 5% or more of an issuer's equity securities are required to file Form 13-D under Section 13(d) of the Exchange Act. This disclosure must be made within 10 days of the purchase and is designed, among other things, to disclose possible takeover attempts of an issuer. Form 13-D also requires the beneficial owner of the securities to disclose the source and amount of funds being used to purchase the shares, and announce whether the purpose of the purchase is to acquire control, as well as any plans or proposals with regard to future actions by the purchaser. Certain investors controlling between 5% and 20% of an issuer, and who do not intend to control or influence control of the issuer, may file Form 13-G instead.

Section 13(f) and Form 13-F. Institutional investment managers who exercise investment discretion over \$100 million or more of U.S. exchange-traded equity securities are required to file a Form 13-F. This form requires a manager to disclose the name of each reportable issuer in the manager's portfolio as of the end of each calendar quarter, as well as the number of shares and their market value. It also provides some information about the manager's voting authority.

While the aforementioned provisions of the Exchange Act provide some means of obtaining transparency with respect to the investments made by sovereign wealth funds, they may not provide the level of transparency needed with respect to foreign-controlled sovereign wealth funds. Exchange Act reporting obligations may fail to provide the SEC staff with the ability to aggregate and compare related data to ascertain the full scope of sovereign wealth fund investment in the U.S., particularly when a sovereign wealth fund may be investing indirectly through a collective investment scheme or directly through multiple U.S. investment managers that may be tasked with managing assets for the sovereign wealth fund on a separately managed

account basis. Many of the same transparency and investment issues that the SEC has faced with the unregulated hedge fund industry are now being faced by regulators and the U.S. government with respect to investment by sovereign wealth funds.³⁷

In addition to the above described Exchange Act reporting obligations, federal banking regulations, state law, and corporate provisions may also provide some transparency and/or restriction of sovereign wealth fund investments in U.S. businesses.³⁸

LOCAL JURISDICTION REQUIREMENTS

While the U.S. government may not impose a strict prohibition on investments by sovereign wealth funds in U.S. businesses or modify its federal regulatory/disclosure scheme, some form of government and/or self regulation regarding sovereign wealth fund investment in the U.S. will inevitably be adopted. In the interim, U.S. money managers will continue to market to, receive investment from, and manage assets for sovereign wealth funds. Until any new regulation is adopted, U.S. investment advisers should at the very least consider the legal issues below when marketing to,

³⁷ The SEC has some of the same concerns with the unregulated hedge fund industry where the SEC believes there is a lack of transparency. See U.S. Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulation*, Report of the Division of Investment Management (1992), available at <http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf>.

³⁸ For example, if a sovereign wealth fund were to acquire over a certain threshold amount (typically 5% or 10%) of a U.S. casino or gaming business, the sovereign wealth fund may be (i) required to seek pre-approval of the acquisition or (ii) instructed to file a disclaimer of control with the state. Many states also have anti-takeover laws, which require the filing of an information statement with the investee company formed in such state. Failure to comply with the foregoing state reporting requirements may result in a sovereign wealth fund being forced to sell the acquired securities and/or subjected to monetary penalties. Public companies also may utilize poison pill provisions to control unwanted takeovers. Such provisions may provide that if a shareholder acquires a specified percentage (e.g., 20%) of the voting securities of the issuer, such shareholder's holdings will be diluted as all other shareholders are offered additional shares of the issuer at a discounted price. There are over a dozen other similar state and corporate provisions that may impact an investment by a sovereign wealth fund directly or indirectly in a U.S. company.

receiving an investment from, or managing money for, sovereign wealth funds.³⁹

Regulatory Requirements. As noted above, sovereign wealth funds are domiciled in many jurisdictions, some of which a manager may not be familiar with in terms of regulation. Sufficient due diligence as to the sovereign wealth fund's home regulatory requirements regarding marketing to, accepting an investment from, or managing money for a sovereign wealth fund must be explored. In conducting such due diligence, a U.S. money manager will need to review, among other things: (i) applicable local licensing and/or registration requirements, including any pre-filing or pre-approval requirements; (ii) whether marketing to collective investment schemes (e.g., mutual funds, hedge funds, undertakings for collective investment in transferable securities), or solicitation of advisory services are prohibited by local regulations;⁴⁰ (iii) any additional local anti-money laundering requirements; and (iv) whether there are any local restrictions on portfolio management (i.e., limits on any types of securities, such as derivatives, that may be acquired or held by a portfolio).

When conducting business abroad, managers must also be cognizant of the Foreign Corrupt Practices Act ("FCPA"), particularly if contemplating making a gift or payment to a non-U. S. person.⁴¹ The FCPA prohibits a U.S. manager or its agent from issuing any type of monetary payment, offer, promise, or authorization of payment with the intention of influencing or inducing a foreign official to engage in foreign trade practices. There are exceptions to this prohibition (e.g., reasonable expenditures). However, a manager should consult with legal counsel to ensure, among other things, applicability of such exceptions.

Contractual Matters. If sovereign wealth fund assets are managed on a separate account basis by a U.S. manager, the prospective manager will need to review the terms of any investment management agreement carefully, including any provisions relating to, among others: (i) governing law and enforceability; (ii) notice of home law jurisdiction regulatory requirements; (iii) discretionary authority; (iv) proxy voting; (v) delegation authority (e.g., clarify whether the U.S. manager may delegate a sleeve of assets to an affiliated or unaffiliated subadviser without prior approval from the sovereign wealth fund); (vi) frequency of providing information with respect to portfolio holdings; and (vii) indemnification.

Frequency, Form, and Content of Reporting Obligations. The management of assets for a sovereign wealth fund also may require some due diligence with respect to the frequency, form, and content of reporting obligations. As noted above, U.S. managers may have reporting obligations under both U.S. federal and state law. Attention should also be paid to whether additional foreign reporting obligations are triggered outside of the U.S. as a result of the investor's status as a sovereign wealth fund.

CONCLUSION

Assets of sovereign wealth funds are forecasted to reach approximately \$10 to \$15 trillion by 2015 and will certainly have an impact on the world economy. What remains unclear is how the U.S. government will oversee the investment of such funds in U.S. businesses and whether it will heed advice to avoid depriving the U.S. marketplace of a needed source of cash. ■

³⁹ Many advisers to sovereign wealth funds have compliance policies and procedures in place to address these matters.

⁴⁰ Active solicitation of advisory services may be precluded in a home jurisdiction. Some exceptions may be available for solicitation of sophisticated clients and/or reverse solicitation (e.g., a sovereign wealth fund client contacts the U.S. manager directly without prompting by the manager or a promoter of the manager).

⁴¹ Foreign Corrupt Practices Act, Pub. L. No. 205-366, Sec. 78dd-1(a) and Sec. 78dd-2(a) (1998). For useful information on the FCPA see the United States Department of Justice website available at <http://www.usdoj.gov/criminal/fraud/fcpa/>.

Appendix I

Where Are Sovereign Wealth Funds Organized?

