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China Investment Corporation: Recent Developments in Performance, Strategy, and Governance

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Executive Summary

Over the past decade, sovereign wealth funds (SWFs) have proliferated and have increased their role in the international economy. China now has four SWFs and accounts for one-fifth of global SWF assets. China Investment Corp. (CIC), China's flagship SWF, has increased its assets from $200 billion to an estimated $500 billion in just five years as a result of funding and other support from the Chinese government.

This report examines the operations and investment strategy of CIC. It also considers how China's SWFs are being regulated in the United States and internationally. The report builds on hearings and research conducted by the U.S.-China Economic and Security Review Commission (USCC) in 2008. At the time, CIC had just purchased equity in Wall Street firms Morgan Stanley and Blackstone. Since then, CIC has bought shares in dozens of publicly traded U.S. companies, partnered with U.S. fund managers, and provided capital to U.S. energy companies.

Following its establishment, CIC signed on to the Santiago Principles, a set of transparency and governance recommendations for SWFs promulgated by the International Monetary Fund (IMF). And yet, questions remain about the objectives and behavior of China's sovereign investors. SWFs are generally based in small, wealthy economies, such as Singapore and Norway. Most are commodity exporters who use SWFs to counter price volatility and transfer wealth to future generations. In contrast, China is the world's second-largest economy and largest commodity importer. It has low per capita income and is a net recipient of foreign investment.

China's SWFs are partly a product of China's economic rise and a government strategy to promote outbound investment. China's industry-heavy, urbanizing economy has registered rising trade deficits in commodities, as well as declining terms of trade due to a lack of control over more profitable industries. SWFs, like other Chinese investors, can mitigate these problems by taking direct equity positions in overseas industries, thereby stabilizing supply and partaking in profits.

But China's SWFs have also served to generate returns on the country's savings. China has controlled its capital accounts and exchange rate in order to promote exports and subsidize domestic production. This policy requires the central bank to pump money into the domestic economy and to deposit dollars received in trade into low-yielding U.S. Treasury securities. That has created inflationary pressures and an inherent risk that the dollar reserves will lose value. The government has used state-sponsored investments to earn a higher return on the dollar reserves than would be provided by U.S. treasuries.

China's SWF strategy is far from coordinated. While most countries have one or two SWFs, China has four – CIC, SAFE Investment Company (SAFEIC), National Social Security Fund (NSSF), and China-Africa Development Fund (CADF) – each established to serve separate interests among branches of the Chinese government. These SWFs must compete for access to foreign exchange reserves with state-sponsored banks and enterprises. The Ministry of Finance (MOF) has advocated that CIC become China's primary outbound investor and has exercised control over the fund's management. On the other hand, the People's Bank of China (PBOC), China's central bank, prefers instead to distribute dollar reserves prudently among several state investors or to manage them through its own subsidiaries.

These disagreements may explain why CIC, China's only officially recognized SWF, has no defined strategy to guide its operations. The fund has only been capitalized twice – with $200 billion in 2007 and $30 billion in 2011 – and has no stable funding mechanism. Because CIC is not owned or outsourced by the PBOC, it has been financed through special government bonds issued by MOF, which has created a significant debt burden for CIC. CIC has been able to grow its assets primarily because it owns stakes in China's major commercial banks. These banks have rapidly grown their assets over the past decade, in part by listing on China's stock exchanges.

CIC has also been ambivalent about its investment strategy. Since incurring losses on Wall Street in 2008, the fund has recruited more staff, reorganized its investment departments, and established offices in Toronto and Hong Kong. CIC has partnered with external fund managers, exacting favorable terms from financial institutions in need of cash during a global economic downturn. But CIC is under public pressure to generate high returns on an annual basis, to justify more funding. As a result, it has taken significant risks and registered volatile returns on its international portfolio.

Counter to its claims of being strictly profit driven, CIC has pursued strategic objectives. It has diverted capital from its outbound portfolio in order to shore up the balance sheets and share values of the domestic banks it owns. CIC has also purchased shares of Chinese state-owned enterprises (SOEs) listed in Hong Kong. Moreover, the fund has worked with international companies in strategic sectors, such as oil and gas, and coordinated these activities with China's state-owned banks and enterprises. Although CIC claims to be a passive investor, it has taken a seat on the board of U.S. energy giant AES and other foreign firms. It has promoted China's economic diplomacy by cooperating with SWFs from other countries and by enhancing China's ownership of assets in advanced economies.

In terms of governance, CIC maintains very close ties to the state. The fund is registered as a wholly state-owned company under China's Company Law, and is required to have a Communist Party Committee. Only three out of 25 board members are not current or former government officials. In 2013, the fund was part of China's once-in-a-decade leadership transition: CIC Chairman Lou Jiwei became the Minister of Finance, and his successor has yet to be named.

To date, international efforts to regulate SWFs have fallen short. Although CIC participated in drafting the Santiago Principles and signed on in 2008, it has failed to meet all of the recommendations in terms of disclosure of its domestic investments, shareholder relations, and auditing practices. Moreover, China's other sovereign investors, which in many cases are less transparent, have not even signed on. CIC and other SWFs are currently subject only to domestic regulation, while international regulation is still vague and nonbinding.

In the United States, the question of how to treat incoming investment from China's sovereign investors remains unresolved. Some policymakers support lenient treatment to encourage foreign investment, while others worry about national security. In terms of actual regulation, the Committee on Foreign Investment in the United States (CFIUS) has so far reviewed only one investment by CIC, because the fund has been careful to keep its equity stakes small. A revised statute could make more of CIC's transactions subject to CFIUS review. The Securities and Exchange Commission (SEC) and Federal Reserve (Fed) have been more active in reviewing financial sector operations by CIC and its banking subsidiaries. Although with some conditionality, the Fed has approved all of the proposals, exempting CIC from many of the rules under the Bank Holding Company Act (BHCA). The Internal Revenue Service (IRS), for its part, has largely exempted SWFs from paying U.S. corporate income taxes by classifying them as a "foreign government."

China's SWFs help perpetuate a broader structural imbalance between deficit and surplus countries in the world economy. Besides improving the regulation of these funds, the U.S. government could continue to push for economic reform in China.

Introduction

Over the past decade, sovereign wealth funds have become major actors in the global financial sector. Like hedge funds, SWFs lie outside the traditional banking system, and many critics argue that they are not sufficiently transparent. There is also an inherent risk that state-sponsored actors will pursue noncommercial objectives; for instance, by acquiring strategic assets in advanced economies. In the United States, these issues became apparent in February 2006, when Congress blocked the sale of port management businesses in six major U.S. seaports to a state-owned enterprise from the United Arab Emirates, citing national security concerns. Misgivings increased in 2007, when several SWFs acquired interests in Wall Street banks. Among them was China Investment Corp. (CIC), China's newly established SWF, which invested billions in private equity fund Blackstone and investment bank Morgan Stanley.

In 2008, the U.S.-China Economic and Security Review Commission (USCC) became one of the first institutions to address the policy implications of outbound investment by China's SWFs. The Commission received testimony from the Treasury Department and the Peterson Institute for International Economics, among other experts.[i] The Commissioners later traveled to Beijing to speak with the leadership of CIC, China's flagship sovereign wealth fund. In its 2008 Report to Congress, the Commission expressed concern about China's SWFs, due to "uncertainty about the Chinese government and the Chinese Communist Party's motivations, strategies, and possible impacts on market stability and national security". It also predicted that China's sovereign investors would establish a substantial and long-term presence in the U.S. economy.[1]

China's SWFs now rank among the largest in the world. They have purchased equities on the U.S. stock exchange, partnered with U.S. fund managers, and acquired large stakes in U.S. financial services and energy companies. The United States is just a small part of the global investments of these funds. At the same time, China's SWFs remain closely tied to the Chinese government. During China's once-in-a-decade leadership transition in March 2013, CIC's Chairman Lou Jiwei became the Minister of Finance and has yet to be replaced at CIC. In turn, the former Minister of Finance, Xie Xuren, was appointed to head NSSF, another one of China's four SWFs.

This report analyzes China's SWFs, with a particular focus on CIC. It poses three questions:

(1) How have China's SWFs expanded? What role do they play in China's economic policy and management of foreign exchange reserves?
(2) To what extent is CIC a commercial or strategic investor, in terms of its investments and governance structure?
(3) How transparent and accountable are China's SWFs, and how well are they being regulated by the U.S. government and the international community?

The report draws on a wealth of data that have become available in recent years. CIC has published detailed annual reports since 2009. The policy literature has expanded, thanks in part to the Sovereign Wealth Fund Initiative at Tufts University. Academics have analyzed SWFs in depth, especially during the global financial crisis. Financial journalists have produced timely reports, and CIC's managers have given several interviews to the press.

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[i] Refer to the USCC's February 7, 2008, "Hearing on the Implications of Sovereign Wealth Fund Investments for National Security." Transcripts available at *http://www.uscc.gov/hearings/2008hearings/hr08_02_07.php*.

The report's main finding is that the Chinese government still has no apparent strategy to guide SWF investments. CIC, the only SWF officially acknowledged by Beijing, lacks a stable funding mechanism and competes with other state-sponsored investors. It holds assets in both the domestic and international economy and pursues both commercial and strategic objectives.

The report is structured in five sections. Section 1 compares China's SWFs to other countries and considers the Chinese government's policy objectives. Sections 2 and 3 examine CIC's efforts to access funding, increase profits, and promote the government's strategic objectives. Sections 4 and 5 analyze governance and regulatory issues.

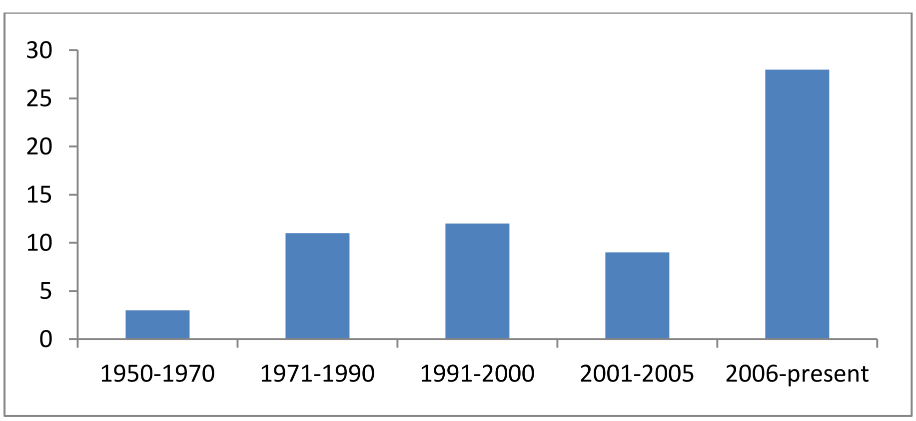
Section 1: Sovereign Wealth Funds in China's Economic Policy

China as an Outlier in the SWF Sector

SWFs date back to the 1950s but have proliferated since the 1990s. Of the 64 SWFs listed by the Sovereign Wealth Fund Institute (SWFI), a private consultancy, over half were established since 2001. According to CityUK, a private consultancy, SWFs doubled their share of the global fund management industry in 2003-11, exceeding the assets of hedge funds and private equity combined. CityUK forecasts SWF assets to be twice as large as the United Kingdom's gross domestic product (GDP) by year-end 2013.[2]

Several factors explain this growth. Sovereign wealth has traditionally been used to stabilize revenues from the sale of commodities, such as oil and gas, and to transfer commodity-based wealth to future generations. Over the past decade, commodity exporters have also benefited from a secular rise in commodity prices, due in no small measure to China's booming demand. At the same time, SWFs have grown in countries that do not export many commodities.[3] According to SWFI data, noncommodity funds increased their share of SWF assets from 28 percent to 43 percent in 2001-11. The rationale for SWFs in these countries is less obvious, since the economy is not as susceptible to market volatility and does not depend on a finite resource. The main reason is that, after being devastated by capital flight during the Asian Financial Crisis in 1997-98, many Asian governments have used their trade surpluses to build up much larger dollar reserves.[4]

Figure 1-1: Number of Sovereign Wealth Funds Established by Time Period



Source: Sovereign Wealth Fund Institute, "Sovereign Wealth Fund Rankings" (Las Vegas, NV). *http://www.swfinstitute.org/fund-rankings/.*

Table 1-1: Growth of Sovereign Wealth Funds: Commodity vs. Noncommodity

	Absolute (US$ bn)		CAGR (%)	Share of total (%)	
	2001	2012	2001-2012	2001	2012
Non-commodity	293	2,214	20%	28%	43%
Commodity	765	2,991	13%	72%	57%
Total	1,058	5,205	16%		

Sources: The City-UK estimates. *http://stagingtcuk.positive-technology.com/research/our-work/reports-list/fund-management-2010*/; Sovereign Wealth Fund Institute.

Countries with large foreign exchange reserves tend to park their holdings in U.S. treasuries, which are considered a safe haven. The purchase of treasuries also supports spending in the U.S. economy, which can boost U.S. demand for exports from SWF countries. However, in the face of a weakening dollar and large external deficits in the United States, these countries have begun to use SWFs to diversify a portion of their holdings into higher-risk, higher-return assets. In the wake of the global financial crisis, there have also been attractive opportunities to buy undervalued assets in advanced economies.[5]

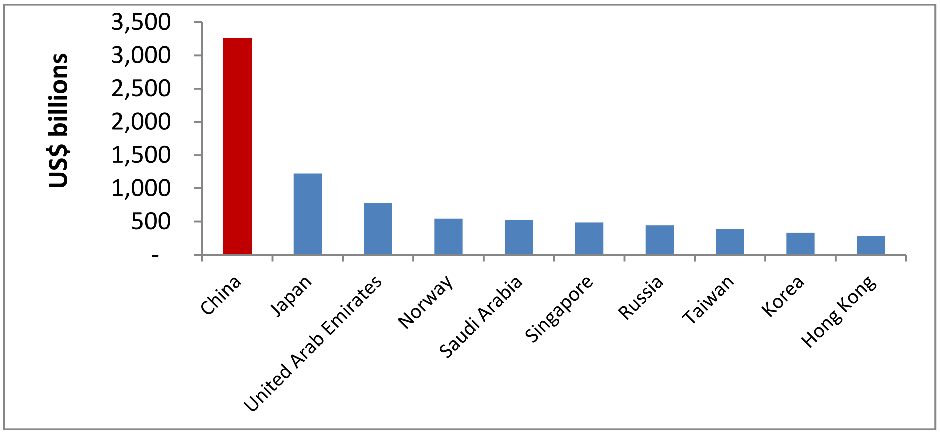
Although China broadly conforms to these trends, it is an outlier among SWF countries. One aspect is its sheer size. The assets of CIC increased from $200 billion to an estimated $500 billion since the fund's creation in 2007, making it the world's fifth-largest SWF. Although the Chinese government recognizes only CIC as an official SWF, the Sovereign Wealth Fund Institute, an independent consultancy, has identified four Chinese SWFs, and ranks them as the third (SAFEIC), fifth (CIC), eleventh (NSSF), and forty-third (CADF) largest in the world.[ii] According to this measure, China by 2011 accounted for one-quarter of global SWF assets, the largest of any country.

Behind these SWFs are China's foreign exchange reserves, which are by far the largest in the world. China is also the largest holder of U.S. treasuries. Even relative to China's huge economy, its reserves are abnormally high. In 2007, the year CIC was founded, China needed an estimated $670 billion of prudential reserves,[iii] but its actual reserves were $1.6 trillion.[6] Although its reserve growth has slowed in the intervening years, China continues to have a vast surplus to invest.

[ii] Experts continue to debate what type of public fund should qualify as an SWF, since the term was only coined in 2005. That has caused some confusion. A fair definition, provided by Ashby Monk, is that SWFs are generally public funds that owe liabilities only to their sponsoring government and invest their assets according to the sponsoring government's interests and objectives. For a detailed analysis, see Appendix Table A-1.

[iii] A common benchmark for prudential reserves is that they suffice to pay off foreign loans; to protect against an outflow of speculative "hot money"; to pay off three months' worth of imports; and to intervene in foreign exchange markets to keep the domestic currency within a certain band. Economists often refer to the Guidotti-Greenspan rule, which states that a country's reserves should equal short-term external debt (one year or less maturity), implying a ratio of reserves-to-short-term debt of 1. The rationale is that countries should have enough reserves to resist a massive withdrawal of short-term foreign capital. Dani Rodrik, "The Social Cost of Foreign Exchange Reserves," *International Economic Journal* 20:3 (September 2006): 255-59.

Figure 1-2: Top-Ten Countries by Foreign Exchange Reserves, 2011



Source: C. Fred Bergsten and Joseph E. Gagnon, "Currency Manipulation, the US Economy, and the Global Economic Order" (Washington, DC: The Peterson Institute for International Economics Policy Brief 12-25 (December 2012).

China is also an outlier in institutional terms. Most SWFs are based in small, wealthy economies, like the Gulf States, Norway, and Singapore. When such states become net exporters, their current account surpluses quickly become large in proportion to the national economy. This structural constraint incentivizes the use of a centralized fund to make profitable, long-term investments overseas.[7] In contrast, China is the world's second-largest economy and the second-leading recipient of foreign direct investment (FDI). China is also not wealthy; in 2011, the World Bank ranked it ninety-ninth worldwide in per capita income.[8] In theory, it should be more difficult for China to accumulate excess reserves, and there should be ample opportunity to make welfare-enhancing investments domestically.

While most countries have just one or two SWFs, China established four entities between 1997 and 2007. Each is unique in terms of its legal basis, governance, and mandate:

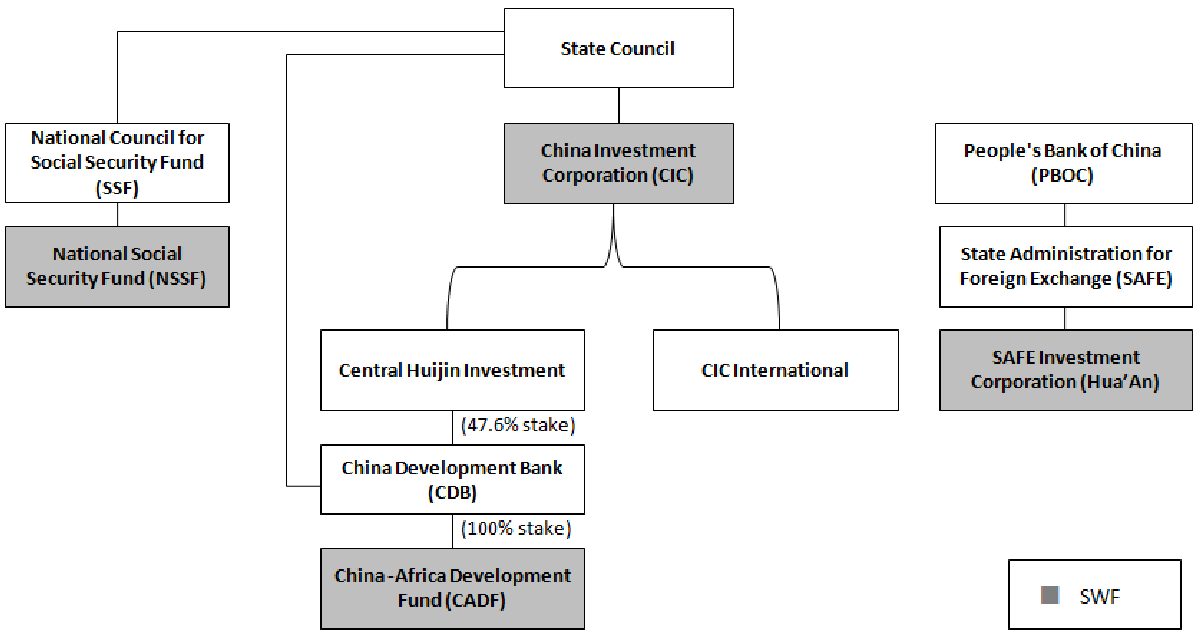
- *SAFE Investment Company (SAFEIC)*[iv] (est. 1997). SAFEIC is a limited company registered in Hong Kong, prior to the handover of the island to Mainland China. It constitutes one of four overseas investment arms of the State Administration of Foreign Exchange (SAFE). SAFE is the branch of the People's Bank of China, China's central bank, which exclusively manages China's foreign exchange reserves. SAFEIC's primary objective is to retain the value of China's foreign exchange by making portfolio investments overseas.
- *National Social Security Fund (NSSF)* (est. 2000). Established by the State Council, under the auspices of the Ministry of Social Security, NSSF is a public pension fund under China's Social Insurance Law. Its objective is to maintain the real value of public pension proceeds as a means to support future social security expenditures. NSSF can invest 20 percent of its funds outside China.
- *China Investment Corp. (CIC)* (est. 2007). Like SAFEIC, CIC is a "company" but is registered as a state-owned enterprise under China's Company Law. Unlike SAFEIC and NSSF, it is not a legal subsidiary of any government agency and reports like a ministry directly to the State Council, the highest administrative body. Under CIC's Articles of Association, five government agencies – PBOC, SAFE, the Ministry of Finance , the Ministry of Commerce

[iv] In China, SAFEIC is referred to as "Hua'an Guoji Touzi Gongsi (华安国际投资公司)".

(MOFCOM), and the National Development and Reform Commission (NDRC) – are allowed to nominate one nonexecutive director to CIC's board. CIC has neither a direct funding mechanism nor any statutory limit on its outbound investments.

- *China-Africa Development Fund (CADF)* (est. 2007). CADF is a small fund set up to foster economic ties between China and Africa. It functions as a branch of China Development Bank (CDB), China's largest policy bank, though various government ministries are represented on its board. It is worth noting that CDB is majority owned by Central Huijin, the domestic subsidiary of CIC (See Section 2 for details).

Figure 1-3: Sovereign Wealth Funds in China's Administrative Structure



Source: "National Social Security Fund [Quanguo Baozhang Jijin]," National Council for Social Security Fund website, http://www.ssf.gov.cn/jj/qgsbjj/201205/t20120507_3993.html; China Investment Corporation, *Annual Report 2011* (Beijing: 2012), p. 11; China Development Bank, *2011 Annual Report* (Beijing: 2012), p. 147; "SAFE Investment Company," Sovereign Wealth Fund Institute. http://www.swfinstitute.org/swfs/safe-investment-company/.

Domestic Factors: Industrial and Monetary Policy

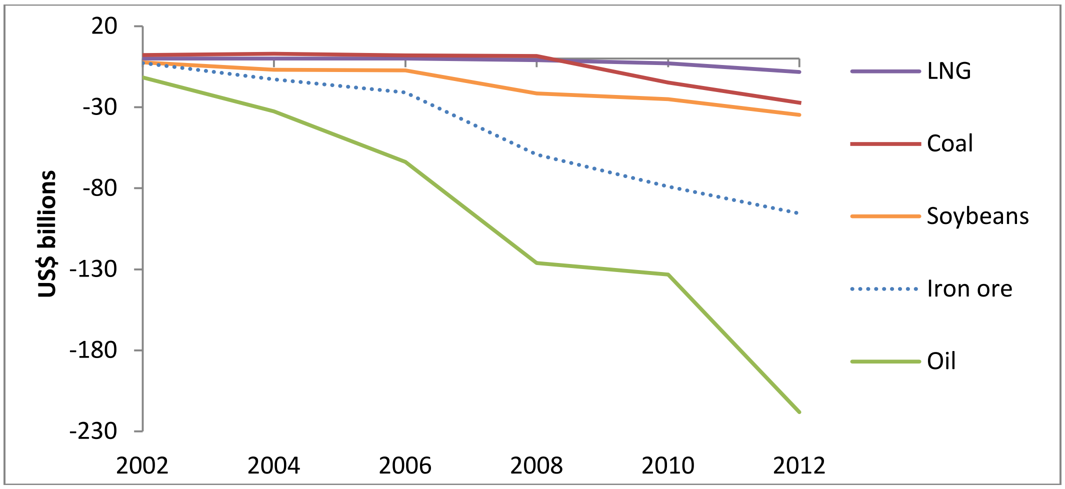
To some extent, China's SWFs are a product of the country's economic rise and a government strategy to promote outbound investment. Since the advent of the Reform and Opening Up policy in 1978, China's GDP growth has far exceeded the world average, on the basis of an export-oriented growth model. In a maturing economy, producers and investors are more integrated into global markets and have accumulated capital to invest overseas.

At the same time, China's industry-heavy, urbanizing economy has registered rising trade deficits in commodities, as well as declining terms of trade[v] due to a lack of control over more profitable

[v] Terms of trade is the ratio of export unit value to import unit value. A high ratio signals that the value of a country's exports per unit is greater than its imports per unit, meaning that the products a country sells overseas are more expensive than the products in imports. Countries with high ratios are regarded to be at an

industries. SWFs, like other Chinese investors, can reduce these problems by taking direct stakes in foreign enterprises, thereby stabilizing China's supply of resources and accruing profits in more lucrative sectors. Due to the government's quasi-monopoly control over outbound investment,[vi] there is also evidence of coordinated outbound investment. In its 10th Five-Year Plan (2001-05), the government introduced the "go global" directive, which encouraged Chinese companies and funds to invest overseas to acquire resources, technology, and know-how.[vii] The directive gained further momentum during the global financial crisis, which provided a rare opportunity to buy undervalued assets in foreign markets.[viii] Since 2008, China's outbound investment has grown steadily and has begun to outpace inbound investment.

Figure 1-4: China's Growing Deficits in Key Resources



Note: LNG=liquefied natural gas
Source: People's Republic of China, General Administration of Customs (Beijing, China: 2013).

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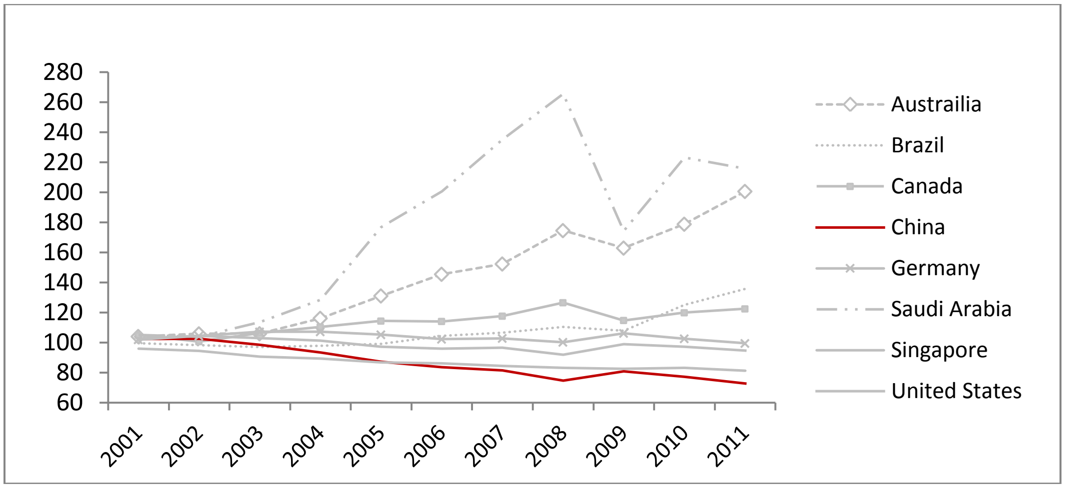
advantage, and have the ability to pay for more imports by selling a smaller amount of exports. Countries with a low ratio, however, need to sell more exports to buy the same amount of imports.

[vi] Although the Chinese government has released decentralized approvals, investments that require over $50 million in foreign currency still require approval of the NDRC and State Council. Moreover, state-owned companies have been investing heavily overseas. For example, according to statistics from Rhodium Group, over 60 percent of China's cumulative foreign direct investment in the United States originates from companies in which the Chinese government has a stake over 20 percent. "China Goes Global: Examining China's Outbound Investment," *China Insights* (Benesch, Friedlander, Coplan & Aronoff LLP: 2010), p.4. *http://www.beneschlaw.com/Files/Publication/58b1c8f1-d679-4051-b50f4631d1cac3b4/Presentation/PublicationAttachment/309b0f83-98ba-4ee8-b03f46526897d787/January 2010.pdf*; Rhodium Group, *China Investment Monitor through Q1:2013* (New York, NY: 2013).*http://rhgroup.net/interactive/china-investment-monitor*.

[vii] The "go global" strategy became an official priority of the Chinese government in 2000 when it was included in the 10th Five Year Plan (2001-05).

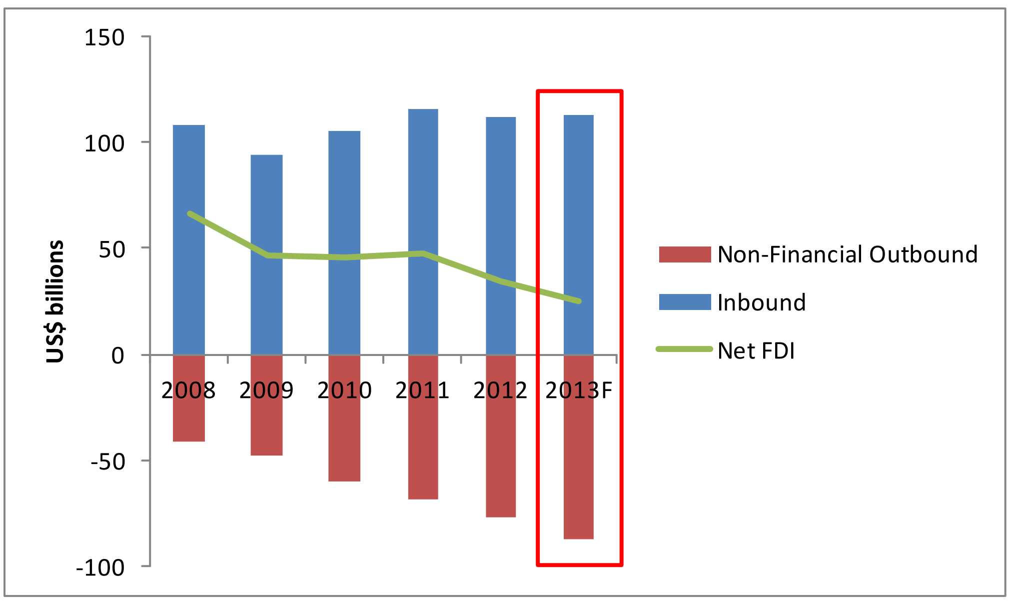
[viii] In July 2009, Premier Wen Jiabao told a meeting of senior Chinese diplomats that the country's vast foreign currency holdings should be used to help Chinese companies "go global," explicitly linking foreign exchange reserves to outward investment and export promotion. Eiichi Sekine, "China's Foreign Exchange Reserves and China Investment Corporation's Steps towards Diversifying How It Manages Its Portion of Them," *Nomura Journal of Capital Markets* 1:4 (Winter 2009): 1.

Figure 1-5: Net Barter Terms of Trade Index, 2001-2011
(2000 = 100)



Source: World Bank (Washington, DC: 2013). *http://data.worldbank.org/indicator/TT.PRI.MRCH.XD.WD*.

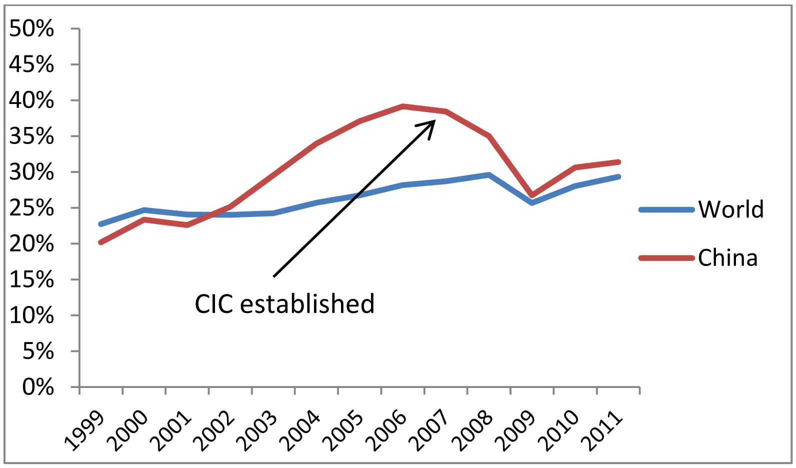
Figure 1-6: China's Inbound and Outbound Foreign Investment



Note: The 2013 forecast is from the National Development and Reform Commission , China's premier planning agency. Outbound investment in the first two months of 2013 exceeded inbound FDI by nearly $1 billion. Bloomberg, "China's Foreign Investment Rebounds as Confidence Returns: Economy,", March 19, 2013. *http://www.bloomberg.com/news/2013-03-19/china-s-foreign-investment-gains-for-first-time-in-nine-months.html.*
Source: China Ministry of Commerce, via CEIC data.

While economic growth and industrial policy have played an important role in the expansion of SWFs, a more salient factor has been China's monetary policy. The years leading up to the creation of CIC in 2007 were formative. Following accession to the World Trade Organization (WTO) in 2001, China opened its markets further to trade and investment and witnessed record levels of dollar inflows. In 2001-06, China's exports vaulted from 23 percent to 39 percent of GDP – an astounding increase, given that real GDP was growing by over 10 percent a year. China also became one of the top three recipients of FDI in the world. As these inflows increased, the central bank came under growing pressure to allow market-based appreciation of the renminbi (RMB) currency, which was set at a fixed rate to the U.S. dollar. Compounding the situation was so-called "hot money," short-term portfolio inflows by investors who speculated that the RMB would increase in value. [ix]

Figure 1-7: Export-to-GDP Ratio, China and the World, 1999-2011



Source: World Bank (Washington, DC: 2012). *http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS.*

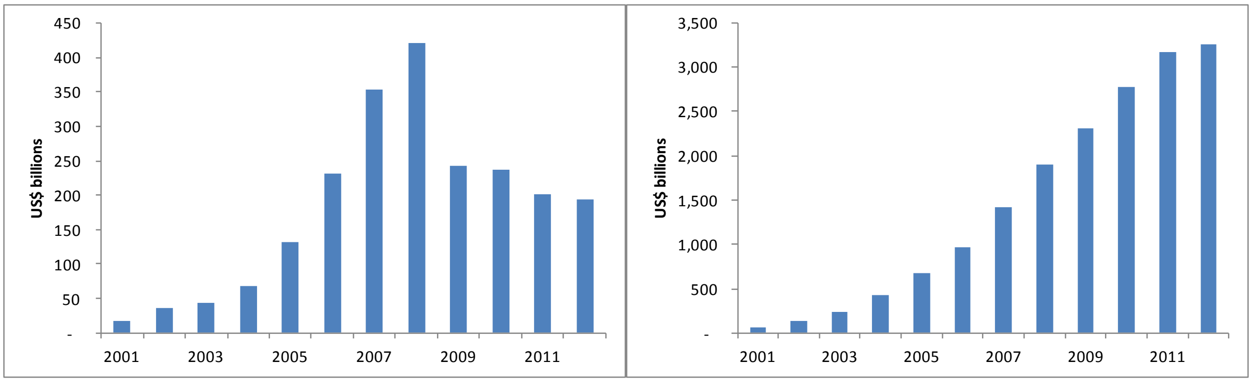
To counteract these pressures, the central bank had to purchase large amounts of foreign exchange and park it in dollar-denominated U.S. treasuries. In the domestic economy, in turn, it had to increase the money supply, causing excess liquidity. To stem inflation, the central bank effectively "soaked up" liquidity by issuing RMB-denominated bonds. Such sterilization proved especially costly when the interest the central bank paid out in RMB exceeded the interest received on U.S. treasuries. There was no easy solution to this problem: Letting the RMB appreciate would reduce the dollar inflows and make it easier to manage the money supply, yet it would also decrease the value of China's dollar holdings and threaten the competitiveness of the export sector. In the summer of 2005, the central bank allowed the currency to appreciate slightly, for the first time since 1994. Yet by 2007, dollar inflows continued unabated, and China began to incur substantial losses on its holdings of U.S. treasuries. [9]

These monetary policy dilemmas were addressed by China's top leadership at the Central Financial Working Conference in January 2007. The leadership concluded that traditional monetary policy tools were not enough to stem rising reserves – China needed to look at options to broaden its investment vehicles to "actively" pursue higher returns on surplus dollar reserves.[10] That led to the establishment of CIC in September of that year. Since 2007, capital inflows have slowed somewhat, and China's currency has appreciated by more than 30 percent in real terms against the dollar. Yet the imperative to diversify China's surplus reserves remains strong.

[ix] The RMB-USD exchange rate was 2.8 in January 1985; 5.22 in January 1990; and 8.7 in January 1994, where it remained until July 2005. Oanda. *http://www.oanda.com/currency/historical-rates/.*

Figure 1-8: China's Current Account Surplus and Foreign Exchange Reserves, 2001-2012

Current Account Surplus *Foreign Exchange Reserves*



Source: China State Administration of Foreign Exchange, via CEIC data.

Section 2: The Funding and Growth of CIC

Policy Disputes over CIC

The Dispute between MOF and the PBOC

A consensus has formed in the Chinese government about the benefits of state-sponsored outbound investment. Even so, there is considerable disagreement on how this should be done. Extensive state influence in China's economy enables strategic coordination but can also lead to bureaucratic infighting.[x] Unlike other leading economies, the Ministry of Finance has no say over China's foreign exchange policy, which is under the exclusive jurisdiction of SAFE, a branch of the PBOC.[xi] As China's dollar reserves have accumulated, MOF has made increasing efforts to wrest control from

[x] Academics have offered many theories on the rivalries within China's large bureaucracy. China policy experts Kenneth Lieberthal and Michael Oksenberg in the late 1980s developed the concept of "fragmented authoritarianism". The term essentially refers to a political system that combines a highly complex bureaucracy with one-party rule. China has parallel agencies in the Communist Party, administrative government, and military, each with central and local level representatives. Moreover, agency jurisdictions often overlap, and some – like the State Council and National Development and Reform Commission – are effectively "super-agencies" that have many functions. At the pinnacle of the system is the Communist Party's 25-member Politburo and seven-member Standing Committee. Major decisions are usually made in the Politburo, while less vital issues are settled by lower agencies. See Kenneth Lieberthal and Michael Oksenberg, *Policy Making in China* (Princeton, NJ: Princeton University Press, 1988).

[xi] The bulk of all foreign exchange, earned either by individuals or by enterprises, has to be sold to SAFE in exchange for China's domestic currency, the RMB, at a rate determined by state economic planners. When individuals or enterprises want to purchase foreign exchange, they have to gain approval from SAFE. These rules were formalized under the Law of the People's Bank of China (1995), which gives the central bank the legal right to own, administer, and manage China's foreign reserves. See Chapter I.5, *Law of the People's Republic of China on the People's Bank of China*. *http://www.china.org.cn/business/laws_regulations/2007-06/22/content_1214826.htm.*

SAFE. Some scholars argue that this dispute climaxed during the Central Financial Working Conference in January 2007, when MOF proposed two solutions to managing China's bulging dollar reserves: (1) the creation of a new SWF to diversify China's foreign exchange holdings; and (2) the creation of a Financial Assets Commission that would manage the assets of China's state-owned financial institutions.[11]

Both proposals were a direct affront to the PBOC. On the one hand, its subsidiary SAFE had decades of experience in managing foreign exchange, with fund management arms in Singapore, Hong Kong, London, and New York. The Hong Kong arm quietly evolved into the largest customers for local treasury bond trading desks at banks such as Morgan Stanley. The proposal to set up a Financial Asset Commission was also controversial, because the largest banking assets were being managed directly by PBOC through Central Huijin, a bank holding company established in 2003.[12]

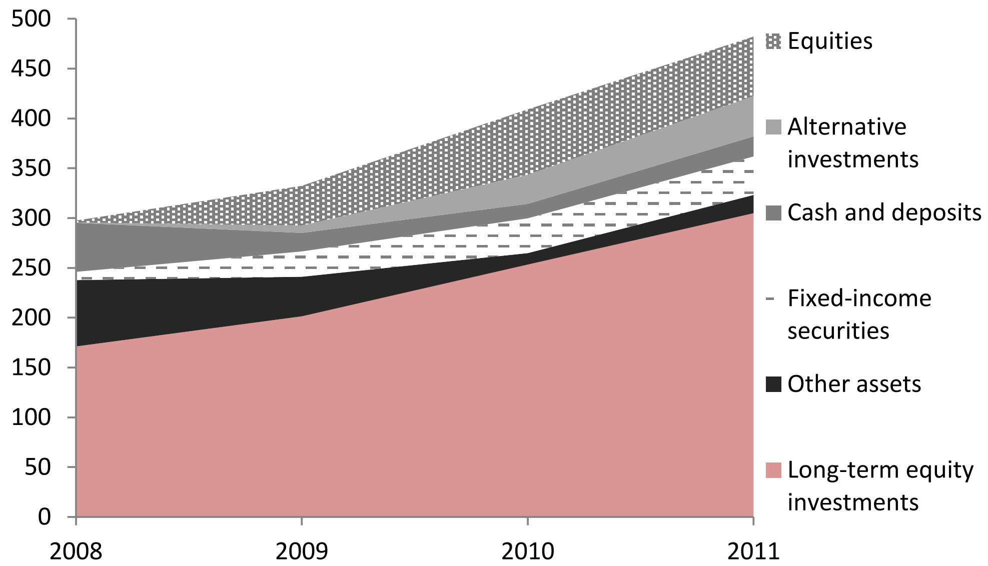
Decisions made at the Financial Work Conference in January 2007 appeared to favor MOF over the PBOC.[xii] The Chinese leadership agreed to establish CIC and handed managerial control to MOF. In order to avoid bureaucratic disputes, CIC's articles of association mandated that five major government agencies – including the PBOC and SAFE – nominate one nonexecutive director to CIC's board of directors.[xiii] Yet the chairmen of CIC's board of directors and board of supervisors were former top officials from MOF and remained in this position in 2007-12.[13] In 2013, CIC Chairman Lou Jiwei vacated his position to become the Minister of Finance. Although his successor is unlikely to come from MOF, day-to-day operations could remain the chief responsibility of incumbent CIC President Gao Xiqing, a Wall Street veteran whom many now view as the international face of the fund (See Section 4 for further discussion of the CIC leadership transition).[14]

MOF not only succeeded in establishing and controlling CIC; the PBOC was also compelled in 2007 to relinquish control over Central Huijin, the bank holding company. Surprisingly, Central Huijin's assets were not placed in a new Financial Assets Commission managed by MOF. That appears to have been politically unacceptable for the PBOC. Instead, Central Huijin was sold at a discounted price of $67 billion to CIC in the fall of 2007. In this way, the government retained its stake in the state banks, to be used as tools of policy, while avoiding a controversial decision about whether to hand them to either PBOC or MOF.[15]

Although officially mandated to make outbound investments, CIC became heavily invested in the domestic financial industry. Central Huijin owned major stakes in 18 leading financial institutions, including China's four major commercial banks, largest policy banks, and largest insurance companies. Among these, ten are majority stakes. Indeed, by 2010, CIC's long-term equity investments in domestic banks accounted for over half of its total assets. These domestic holdings also generated massive investment income in 2008 and 2011 that offset losses in the fund's international portfolio.[xiv]

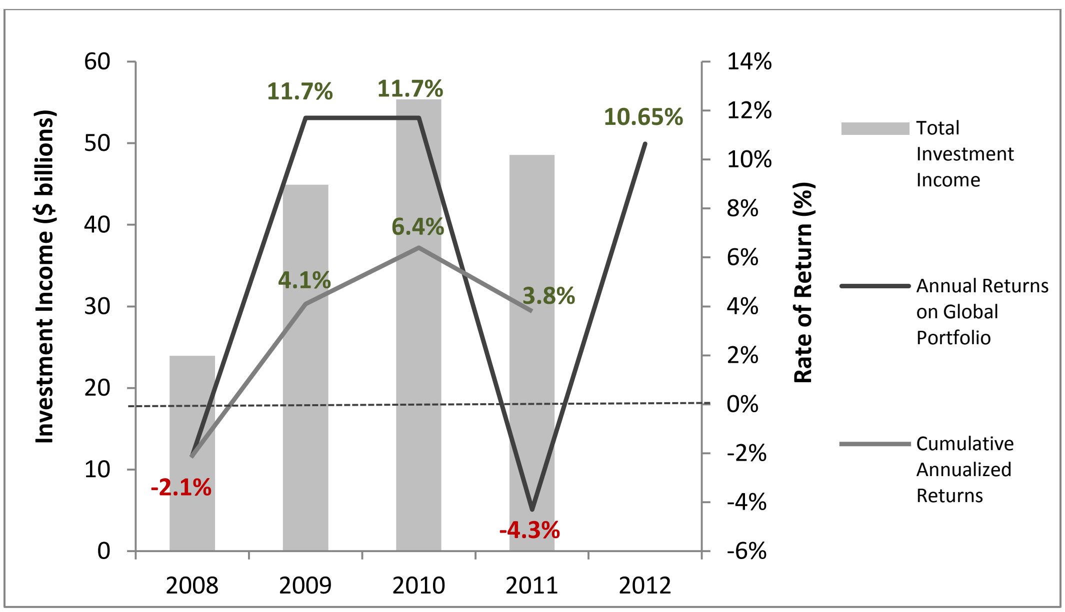
[xii] U.S. political scientist and China expert Victor Shih has speculated that the MOF proposals were backed by Premier Wen Jiabao, who was in charge of China's Financial Leading Group, and had a close personal relationship with then Vice-Minister of MOF, Lou Jiwei, who became CIC's Chairman. Victor Shih, "Tools of Survival: Sovereign Wealth Funds in Singapore and China," *Geopolitics* 14:2 (2009): 334-35.
[xiii] Hu Xiaolian served as Non-Executive Director at CIC while serving as Director of SAFE in 2007-09. After she left to become Deputy Governor of the PBOC in 2009, she was replaced by Fang Shangpu, Deputy Administrator of SAFE. China Investment Corp. annual reports 2008-2010.
[xiv] See Holdings of Central Huijin (Table A-5) and CIC Financials, 2008-11 (Table A-10) in the Appendix.

Figure 2-1: CIC Total Asset Distribution ($ billions)



Note: Long-term equity investments are principally comprised of investments by Central Huijin.
Source: China Investment Corporation, *2008-2011 Annual Reports* (Beijing, China).

Figure 2-2: CIC Global Investment Portfolio Annual Returns vs. Total Income



Sources: China Investment Corporation, *2008-2011 Annual Reports* (Beijing, China);
Wall Street Journal, "China CIC Exec: 2012 Overseas Investment Return Was 10.65%," March 5, 2013. *http://online.wsj.com/article/BT-CO-20130305-715944.html*.

The Funding Dilemma

The creation of CIC, and its control over domestic banking assets, arguably boosted MOF's influence over monetary policy. Yet CIC inherited serious structural flaws. SWFs are typically established either as legal entities separate from the central bank or as a pool of assets managed by the government. SWFs also tend to have a fixed funding mechanism (e.g., export revenues) and sound rules outlining conditions for the withdrawal of SWF capital, such as fluctuations in commodity prices. In contrast, CIC is registered as an independent, state-owned enterprise. It is neither outsourced to manage funds on the PBOC's behalf, nor a subsidiary of the PBOC. It also has no sound rules regarding the receipt or withdrawal of funds. [16] Indeed, because CIC is classified as a "nonbanking institution," the PBOC is forbidden by law to inject capital into CIC without approval of the State Council, which acts as CIC's official shareholder.[17] The result is that CIC must lobby the State Council and its subordinate ministry, MOF, to appropriate more funding on its behalf.

In March 2011, CIC Executive Vice President Wang Jianxi told the *Wall Street Journal* that the fund was seeking a "clear funding mechanism just like what other, more mature funds have" and noted that CIC was "working with certain government entities on setting up such a mechanism."[18] Among the proposals has been direct capital injection by SAFE, effectively giving SAFE an equity stake in CIC. Another proposal would be for SAFE to entrust CIC to invest foreign exchange on its behalf – essentially an outsourcing relationship.[19] So far, however, no new arrangement has been made. In 2011, Chairman Lou Jiwei stated that he preferred more capital injections from MOF.[20] A potential explanation is that if SAFE were to directly inject capital, its equity stake in CIC would diminish MOF's managerial influence over CIC.

Lacking a stable funding mechanism, CIC has received only limited and erratic funding. SWFs in most countries manage the bulk of their country's foreign exchange; CIC's initial capitalization was $200 billion, accounting for just 15 percent of China's total reserves in 2007. Moreover, CIC has since received just one additional capital injection from the PBOC – a paltry $30 billion in December 2011. The sum was only confirmed in July 2012, after contradictory statements by CIC's leadership and false speculation in the media.[xv] Many experts had expected CIC to receive an additional $100 billion a year.[21]

[xv] CIC's second capital injection was a lengthy and chaotic process. In August 2009, Chairman Lou Jiwei stated that CIC might ask for more funds if its returns were solid and the country's currency reserves continued to rise. The reserves grew by $188 billion in the final four months of that year, ending 2009 at $2.4 trillion—$1 trillion more than the level than when CIC was established. In late 2009, Chinese media began to report that CIC was seeking $100 billion-$200 billion in additional funding. In March 2010, on the sidelines of the National People's Congress (NPC) annual meeting, CIC Executive Vice President Jesse Wang told reporters that CIC was short of cash and urged the National People's Congress to approve a plan to inject more capital. A week later, Yi Gang, the newly appointed head of SAFE, acknowledged for the first time that SAFE was studying this plan. But it was only a year later, in March 2011, during the next round of annual NPC meetings, that the central government's budget proposal included a bond program to inject funds into CIC, which was submitted to the NPC budget committee for review. In December 2011, an anonymous source told Reuters news agency that CIC was set to receive additional funding of $50 billion, which fueled media speculation in the ensuing months. However, CIC acknowledged in its annual report in July 2012 that it had received only $30 billion in additional capital, issued in December 2011. Dinny McMahon, "CIC Offers a Glimpse into U.S. Holdings," *Wall Street Journal* online, February 9, 2010, via Factiva; Reuters, "Exclusive: China's CIC to Get $50 Billion Boost," December 23, 2011. *http://www.reuters.com/article/2011/12/23/us-china-sovereign-idUSTRE7BM09A20111223*; Dow Jones International News, "China NPC: SAFE: Undecided on CIC Funding, to Grow Private Investment," March 8, 2010, via Factiva; Li Qing, "Fresh Capital En Route for Sovereign Fund CIC," *Caixin* online, May 17, 2011, via Factiva; *Jingji Cankao Bao,* "Rumors that CIC Has Already Been Approved for Capital Injection, Lou Jiwei Has Declined to Comment [Chuan Zhongtou yi huo Yanghang xin zhuzi Lou

Table 2-1: CIC Capital Injections

Year	Amount ($ billions)
Sep 2007	$200
Dec 2011	$30
Total	**$230**

Source: China Investment Corporation*, 2011 Annual Report* (Beijing, China: July 2012).

What is more, CIC's funding has come in the form of debt instead of equity. For the initial capitalization of CIC, MOF issued special government bonds denominated in RMB that were purchased by China's commercial banks. The proceeds were then used to buy foreign exchange from the PBOC. For the PBOC, this was an expedient way to stabilize China's financial sector: The massive bond purchases effectively drained liquidity from bank balance sheets and stemmed inflation in much the same way as a bond issued by the PBOC in open market operations would do. For CIC, though, paying back the principal and interest on these bonds has been expensive.[22, xvi] It was reported that CIC and MOF agreed to classify the $200 billion capitalization as assets rather than debt in an effort to mitigate the debt burden on CIC. If this information is accurate, then MOF is now a partial shareholder in CIC entitled to dividend payments.[23, xvii] Yet this cosmetic change would have done little to ease the pressure on CIC to achieve high returns, and its second capital injection in 2011 was reported to again be in the form of debt.[24]

The competitive advantage of SWFs over other investors is arguably their ability to invest in the long term, since they are not accountable to individual shareholders. Owing to its funding arrangement, however, CIC has difficulty pursuing this model, because it needs to justify further funding and service its debts. Former CIC Chairman Lou stated soon after the founding of CIC that, based on the debt owed to MOF, the fund "needs to make RMB 300 million [US$46.6 million] on an average workday" to cover interest payments to MOF.[25] In its 2010 annual report, the fund claimed a shift in CIC's asset-allocation strategy to reflect the growing importance of long-term investments and its decision to adopt a ten-year time horizon for its portfolio.[26]

CIC as a Domestic Investor

CIC's ownership of domestic banking assets has also hampered its efforts to become a dedicated outbound investor. CIC took a vested interest in the solvency and profitability of the banks managed by Central Huijin, both to please the policymakers in Beijing as well as to maintain the value of its own assets. CIC was thus compelled to divert a large chunk of its capital to the domestic financial sector. About $100 billion of CIC's initial $200 billion in funding was transferred to domestic financial institutions through Central Huijin.[27, xviii]

Jiwei wei yu zhiping]," February 14, 2012. *http://news.xinhuanet.com/fortune/2012-02/14/c_122698414.htm*; and Simon Rabinovitch, "China Fund Loses 4.3% on Global Portfolio," *Financial Times,* July 25, 2012, via Factiva.

[xvi] The bonds in 2007 were issued in eight tranches at terms of ten years and 15 years, with interest ranging from 4.3 to 4.7 percent. CIC would have to repay this debt in RMB, even as the RMB further appreciated against the dollar, the currency in which CIC expected to earn its returns overseas.

[xvii] CIC reached the agreement with MOF in August 2009, according to an anonymous source from CIC in an interview with *China Economic Observer*. *China Economic Observer.* "CIC No Longer to Pay Interest to the State,", August 26, 2009. *http://www.eeo.com.cn/ens/homepage/briefs/2009/08/26/149395.shtml.*

[xviii] Huijin undertook a US$19 billion capital injection into Agriculture Bank of China Ltd., in preparation of its listing on the stock market. It also issued its own bonds worth $28 billion, which were bought by three

Coupled with CIC's funding problems, the diversion of capital to the domestic banking sector has left the fund with very little capital to invest abroad. In 2009, the fund went on a spending spree that depleted its cash and deposits from $47.8 billion to $18.6 billion within one year. In 2010, cash and deposits sank further to $14.4 billion, and in 2011, increased only slightly to $20.1 billion.[xix]

Furthermore, ownership of domestic bank shares has damaged CIC's credibility among foreign governments. That became especially evident at the Strategic and Economic Dialogue (S&ED) meetings between the United States and China in June 2008. At the meeting, U.S. negotiators put considerable pressure on China to clarify the domestic assets of its new SWF. The concern was that not only CIC, but also its banking subsidiaries – Industrial and Commercial Bank of China, Bank of China, and Agricultural Bank of China – were acquiring banking licenses to operate in the United States.[28]

Soon after the conclusion of the S&ED meetings, CIC decided to reorganize Central Huijin's board of directors to be independent of the CIC board.[29] At a meeting in late 2010, China's leadership also debated whether to split Central Huijin off from CIC. However, the proposal did not go through, apparently due to concerns that either the PBOC or MOF would fight to take over Central Huijin. Central Huijin's management also preferred to work under CIC, due to the benefits that come with an international institution with market and policy functions.[30]

Instead, CIC came to a piecemeal solution, formally splitting its domestic and foreign investment operations in December 2011. It created a new entity, CIC International, which served as an umbrella for CIC's outbound investment departments and overseas offices. Upon its establishment, CIC International was provided CIC's second capital injection of $30 billion in December 2011, "in a bid to enhance its role as a vehicle to diversify China's foreign exchange holdings."[31] The move was designed to reassure the outside world that CIC International was a separate investment entity that would not be affected by domestic considerations.

These governance reforms have not, however, resolved the underlying problem of owning domestic assets. Contrary to claims of a "firewall" between domestic and international subsidiaries, CIC's chairman remains in charge of both CIC International and Central Huijin's boards. CIC also retains a vested interest in the profitability of China's state-owned banks to help increase the value of its balance sheet. Central Huijin, nominally barred from intervening in the banks' management, has continued to inject capital in them when necessary. [32]

CIC's Commercial Investment Strategy

Asset Allocation

SWFs assume varying levels of risk. On one end of the spectrum is the Russian Reserve Fund, which places nearly all its assets in fixed-income securities issued by foreign governments; on the other end is Temasek Singapore, which invests in assets that are less liquid and require high levels of capital upfront. CIC has considerable leeway to take risks within its mandate, which vaguely states

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domestic banks, and then used part of the proceeds to buy shares in those same banks, effectively inflating the banks' balance sheets.

[xix] China Investment Corporation, *2011 Annual Report* (Beijing, China: July 2012), p.41.

that the fund should "diversify China's foreign exchange holdings and achieve higher long-term returns within acceptable risk tolerance."[33]

Table 2-2: Comparison of Risk Appetite among Major Sovereign Wealth Funds

Low Risk → High Risk

SWF	Cash/ Gov. Bonds	Fixed Income	Equity	Real Estate	Hedge Funds	Private Equity	LBOs (Leveraged Buyouts)
Sovereign Stabilization Funds							
Russian Reserve Fund	✓						
Sovereign Saving Funds							
Timor Leste Petroleum Fund	✓						
Norway Gov. Pension Fund	✓	✓	✓				
Australian Future Fund	✓	✓	✓				
GIC Singapore	✓	✓	✓	✓	✓	✓	
Qatar Investment Authority	✓	✓	✓	✓	✓	✓	
China Investment Corporation	✓	✓	✓	✓	✓	✓	
Abu Dhabi Investment Authority	✓	✓	✓	✓	✓	✓	
Kuwait Investment Authority	✓	✓	✓	✓	✓	✓	
Libyan Investment Authority	✓	✓	✓	✓	✓	✓	
Government Investment Corporations							
Vietnam Capital Investment Corp.	✓	✓	✓	✓	✓	✓	✓
Temasek Singapore			✓	✓	✓	✓	✓

Source: Adapted from Eliot Kalter, "Sovereign Wealth Funds: Public Policy and Asset Allocation After the Financial Crisis" (Presentation at Fletcher Sovereign Wealth Fund Institute, Tufts Fletcher School, Medford, MA, October 2010). *http://fletcher.tufts.edu/SWFI/~/media/151C34D306464CB38676207D0927306A.ashx.*

CIC took its first risks when it committed over $8 billion to buy equity in Wall Street firms Blackstone and Morgan Stanley in 2007. It made the investments just prior to the 2008 financial crisis, which resulted in major losses for the fund. CIC was not the only SWF to register substantial losses on Wall Street during the financial crisis; yet negative returns spread a reputation in China that CIC is a poor investor. For example, Ceng Gang, an economist at the Chinese Academy of Social Sciences Institute of Finance and Banking, a quasi-government think tank, has argued that CIC's initial Wall Street investments were "undeniably premature," because the fund had not had time to "analyze the current market situation and perfect their internal management."[34]

After retrenching in 2008, CIC received official backing in 2009 to resume its aggressive investment strategy.[xx] CIC announced more than $8.15 billion of new acquisitions in 2009.[35] It began by acquiring more equities, which jumped from 3 percent to 43 percent of the portfolio within one year.[36] These included many small portfolio (<10 percent) stakes in publicly listed companies in the United States. CIC also made a series of equity investments beyond 10 percent in foreign companies, with a focus on energy and mining. Major investments included U.S. energy giant AES

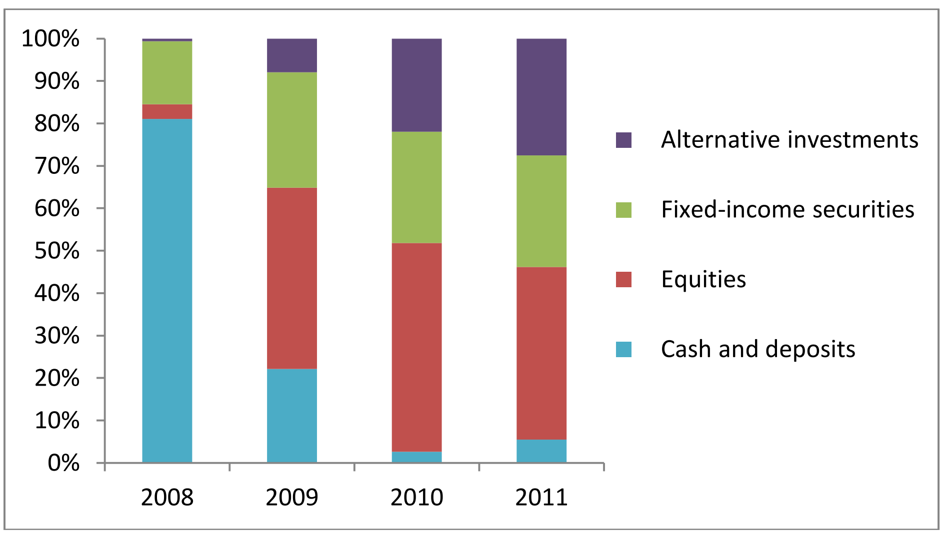
[xx] A 2009 editorial in the *People's Daily*, China's Communist Party-affiliated newspaper, reemphasized the role of CIC in diversifying China's foreign exchange reserves. Eiichi Sekine, "China's Foreign Exchange Reserves and China Investment Corporation's Steps towards Diversifying How It Manages Its Portion of Them," *Nomura Journal of Capital Markets* 1:4 (Winter 2009): 14.

and Canadian mining company Teck Resources. At the end of 2011, when CIC was confident it would receive a second capital injection from the central bank, it resumed aggressive purchases of energy companies, including France's GDF Suez and Canada's Sunshine Oilsands.[37]

Further, CIC allocated more capital to alternative investments – a group of riskier asset classes comprising real estate, energy funds, hedge funds, and private equity. These jumped from 8 percent to 22 percent of the fund's financial assets in 2009-11. When CIC disclosed its investments in a filing to the Securities and Exchange Commission (SEC) in 2010, it revealed more than $1.5 billion of investments in 14 U.S.-based index funds. In April 2008, CIC also provided $4 billion to JC Flowers, a leading U.S. private equity firm, and upped its share in Blackstone.[38] CIC's hedge fund portfolio kicked off in 2009 with the appointments of Oaktree Capital Management, Capula Investment Management, and Blackrock to manage over $2 billion.[39, xxi]

CIC also entered real estate, considered by CIC's managers to be a safer bet than financial services and commodities.[40] In November 2010, it purchased a 7.6 percent interest in General Growth Properties Inc., a company with significant holdings in the U.S. real estate market. Just three months later, it joined AREA Real Estate Finance Corp to jointly acquire a preferred equity stake in a 27-story office building owned by Carlyle Group in Madison Avenue in Manhattan, home to the headquarters of Polo Ralph Lauren Corp.[41]

Figure 2-3: Breakdown of CIC's International Investments (Financial Assets)



Source: China Investment Corporation, *2011 Annual Report* (Beijing, China: July 2012).

It is uncertain whether this higher-risk investment strategy is paying off. Due to the strong performance of its domestic holdings, CIC's cumulative returns have been fairly stable. And yet, the

[xxi] To reflect this new investment strategy, CIC divided its "alternative investments" in 2011 into more concise categories. "Absolute returns" include primarily investments in hedge funds. "Long-term investments," in turn, comprise nonliquid direct investments in overseas companies, private equity, property and infrastructure, and commodities. CIC also reclassified its equities as "diversified public equities" in order to clarify that these were not long-term investments in companies overseas, but rather liquid shares in publicly listed companies. China Investment Corporation, *2011 Annual Report* (Beijing, China: July 2012), p.19.

returns on its international portfolio have been volatile.[xxii] CIC registered double-digit gains on its outbound investments in 2009, 2010, and 2012, and negative returns in 2008 and 2011. In good years, CIC's management has not hesitated to highlight its competitive edge. In bad years, in turn, it has attributed poor performance to a "subdued global economic landscape" and noted that some other SWFs have taken similar risks.[42] Overall, the perception among many observers in China is that CIC is not yet a dependable investor.

Asset Management

While struggling to find an optimal allocation for its assets, CIC has continually changed the way it manages its investments. CIC has outsourced 57 percent of its global investment portfolio and has made over 30 major transactions with external fund managers. CIC has adroitly leveraged its bargaining power in a market short of liquidity. It has not only entrusted money to outside managers but also has purchased equity in fund management firms, becoming a partial owner rather than just a client. CIC has also let funds compete against one another; in February 2010, it provided the $500 million in funding each to three different fund managers – Goldman Sachs, Lexington Partners, and Pantheon Ventures – and then discontinued its funding for Pantheon eight months later.[43]

Over time, CIC has made efforts to increase its in-house capacity as well. In 2008-11, the fund's staff nearly doubled from 194 to 376.[44] Among its high-level recruits was Gao Xiqing, the former manager of NSSF, China's other SWF, who was appointed in 2009 to head CIC's investment strategy. CIC also used the central government's Recruitment Program of Global Experts, also known as the "1000 plan," to target Chinese nationals working in the U.S. financial sector.[xxiii]

A turning point came in February 2010, when Chairman Lou announced that CIC would increase the proportion of funds managed internally, because "our funds managed by external managers have not performed especially well."[45] In November of that year, CIC International (Hong Kong) Co., Ltd., CIC's first overseas subsidiary,[xxiv] was established. CIC referred to the new entity as "a key platform for investment and financial trading activities such as fiduciary services and public listing of companies in which CIC has invested."[46] Just two months later, CIC opened a "representative office" in Toronto, with the goal of identifying promising investment opportunities in Canada's resource-rich economy.[47]

CIC's hiring push and the establishment of overseas offices have increased CIC's talent pool and ability to advise and manage its own investments. Internal management of its overseas portfolio

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[xxii] It is difficult to benchmark investment performance among SWFs, as the metrics used by different funds are not standardized, and some do not even publish annual returns.

[xxiii] An example is Fan Gongsheng, a PhD in mathematics from Columbia University, who worked in the U.S. banking sector for over 20 years. Dr. Fan was recruited to work at CIC under the "1000 plan" in 2008. He became director of CIC's fixed income and absolute return division in September that year. In November 2011, he was promoted to president of CIC's Hong Kong subsidiary, CIC International (Hong Kong) Co., Ltd. Baidu, *http://baike.baidu.com/view/3707201.htm; Oriental Morning Post*, "CIC's Hong Kong Subsidiary's Senior Executive Appointed [Zhongtou Xianggang Zigonsi Gaoguan Yi Daowei]," November 4, 2011. *http://finance.eastmoney.com/news/1354,20111104174116378.html*.

[xxiv] CIC International (Hong Kong) Co., Ltd. is not to be confused with CIC Investment Corporation International Co., Ltd., CIC's branch responsible for managing overseas investment. For details, see CIC Organizational Structure (Figure A-3) in the Appendix.

moderately increased from 41 percent to 43 percent in 2011.[48] However, the majority of CIC's overseas portfolio remains under external management.

Competition with Other Sovereign Investors

The founding of CIC did not prompt any precise rules as to what share of China's foreign exchange reserves the fund should receive or how it should coordinate its investments with other actors in China's economy. As a result, experts continue to dispute whether there is indeed a rivalry among Chinese investors to justify access to the PBOC's dollar reserves. Brad Setser of the Council on Foreign Relations argues that China's reserves are so large as to discourage competition.[49] Others argue that there is some division of labor in terms of the types of investments and the degree of risk assumed by different investors in China. The bulk of SAFE's reserves still consists of government bonds, cash, and other liquid assets, and it announced informal plans in 2013 to allocate only 5 percent of its reserves to riskier asset classes.[50] Similarly, NSSF's allocation of investment is more tightly controlled than CIC's, and any change in its mandate must be approved by the State Council.[51]

Judging by the past six years, however, competition among sovereign investors in China is intensifying nonetheless. As Patrick J. Schena, a scholar at the Sovereign Wealth Fund Institute at Tufts University, has noted:

[…] with the formation of CIC, there appeared to exist grounds for a natural delegation of investment mandates: SAFE to invest China's overall foreign exchange reserve position; CIC to invest excess reserves. The evolving reality is far more nuanced. While the preponderance of China's reserves sit in U.S. government securities, SAFE has been nothing of an exclusively passive investor.[52]

Political scientists Sarah Eaton and Zhang Ming have even posited a "sovereign wealth fund tournament" by conscious design: "Although China's SWF tournament emerged as a quite unintended consequence of bureaucratic politics, China's leadership has since tacitly endorsed this rivalry because it has supplied the government with valuable carrot and stick mechanisms with which to discipline fund managers."[53]

CIC's main rival would appear to be SAFE's subsidiary SAFEIC. During the global financial crisis, it invested US$150 billion to $200 billion in U.S., European and Australian equities, including a 1.6 percent minority stake in oil and gas giant Total SA worth $2.8 billion.[54] After sustaining some losses during the crisis, SAFE disappeared from the radar for some time. In 2011, it recruited for multiple vacancies in Hong Kong to enhance its in-house asset-management capability. In early 2013, the *Wall Street Journal* reported that SAFE had used a third-party investor, Gingko Tree, to purchase real estate and utilities in the United Kingdom (UK) worth at least $1.6 billion.[55] SAFE also created a new Co-Financing Office in 2011 to make "innovative use" of China's reserves in order to "support financial institutions in serving China's economic growth and going-out strategy."[56]

Table 2-3: SAFE Investments in the United Kingdom

Company/property	Investment type	Date	Stake (%)	Investment ($ millions)
UPP Group Holdings	University housing	Jan-13	40%	885
Drapers Gardens	Office building	May-12	100%	438
Affinity Water	Water utility	Jun-12	10%	186
One Angel Square	Office building	Dec-12	49%	107

Source: Adapted from Dinny McMahon and Wei Lingling, "China Quietly Invests Reserves in U.K. Properties," *Wall Street Journal*, February 24, 2013. *http://online.wsj.com/article/SB10001424127887323699704578323670119279066.html*.

NSSF is also emerging as a competitor. In late 2009, its Chairman Dai Xianglong announced that the fund had obtained permission to invest as much as 20 percent of its assets in overseas stocks and funds, 13 percent higher than the share until then. That would give NSSF the capacity to invest approximately $US30 billion to $40 billion overseas in a variety of assets.[57] These announcements coincided with CIC's renewed overseas acquisitions in late 2009. In April 2010, Chairman Dai projected that NSSF would more than double in size to $300 billion by 2015. [58]

In addition to SWFs, foreign exchange reserves are being distributed to state-owned banks. Of particular note is CDB, China's major policy bank. Set up in 1994, it is mandated to provide policy loans at below-market rates, as distinguished from commercial lending by commercial banks. However, the bank has exploited its sovereign credit rating and low capital adequacy ratios to pursue more profitable lending and has increasingly done so beyond China's borders. CDB's foreign exchange loans in 2005-11 grew at twice the rate of the bank's overall loans and increased their share of total loans from 7.5 percent to 21.5 percent. CDB has played a central role in the government's "go global" strategy to fund Chinese companies investing abroad.

Table 2-4: China Development Bank: Assets, Disbursements, and Foreign Currency Loans

	2005	2006	2007	2008	2009	2010	2011	CAGR
Assets ($ billions)	235.6	296.7	394.7	559.5	665.9	769.9	984.6	26.7%
Disbursements ($ billions)	214.8	258.7	308.6	424.4	543.8	679.2	869.9	25.9%
FX loans ($ billions)	16.2	28.7	30.5	64.5	82.7	141.3	187.3	54.2%
FX loans as share of total CDB loans	7.5%	11.1%	9.9%	15.2%	15.2%	20.8%	21.5%	
FX loans as share of CDB loan growth	--	28.6%	3.6%	29.4%	15.2%	43.3%	24.1%	

Note: CAGR = Compound Annual Growth Rate; FX= Foreign Exchange
Source: China Development Bank, *2005-2011 Annual Reports* (Beijing, China).
http://www.cdb.com.cn/english/Column.asp?ColumnId=91.

Like CIC, these other state-sponsored investors are working closely with international fund managers. In 2008, SAFEIC led the way with a $2.5 billion investment in a fund run by U.S. private-equity firm TPG, which joined the buyout firm in taking a stake in Washington Mutual, Inc.[59] SAFEIC also committed $500 million to a real estate private-equity fund managed by Blackstone Group LP.[60] NSSF, for its part, received permission in June 2008 to invest up to 10 percent of its portfolio in China's domestic private equity funds.[61] As a result, it became a pioneer for investing in this nascent industry. In July 2012, NSSF announced that it had signed agreements with 12 global investment managers.[62] Two months later, the *Wall Street Journal* passed on a rumor that NSSF was also considering investing in foreign private-equity funds.[63,xxv] CDB, in turn, has purchased minority stakes in European banks Barclay's and ABN Amro. In May 2011, it joined two foreign SWFs, Singapore's GIC and the Kuwait Investment Authority, to buy a 4.5 percent stake in TPG, marking its entry into the private equity space.

Table 2-5: China's Sovereign Investors Working with Major Fund Managers

		Chinese State-Sponsored Investor				
		CIC	**SAFE**	**NSSF**	**CICC**	**CDB**
Firm	**TPG Capital (USA)**[xxvi]		✔			✔
	Carlyle Group (USA)[xxvii]	✔	✔		✔	
	CDH Investments (Hong Kong)[xxviii]			✔	✔	
	Blackstone Group (USA)[xxix]	✔	✔			

Source: See footnotes below.

[xxv] China's burgeoning private equity market has attracted U.S. firms, such as Blackstone, Carlyle Group, and TPG, looking to shift capital from the recessionary markets in the United States and Europe to emerging markets. In December 2011, the NDRC issued the first nationwide regulations governing private equity and venture capital funds, helping U.S. firms to enter this market. ," *Asia Private Equity Review*, "China's Institutional Investors Are Buying Home Assets," February 1, 2009, via Factiva.

[xxvi] *TPG Capital:* In 2008, SAFE invested US$2.5 billion in a TPG managed fund. CDB Capital, a wholly owned subsidiary of China Development Bank, purchased a minority stake in TPG in 2011, which established a cooperative partnership between the two firms. *Financial Times*, "China's Safe to Invest $2.5bn in TPG Fund," June 10, 2008. *http://www.ft.com/intl/cms/s/0/d793921e-3714-11dd-bc1c-0000779fd2ac.html#axzz2VFWfhCDu*; *People's Daily*, "China Development Bank to Buy Stakes in U.S. Private Equity Fund," May 28, 2011. *http://english.peopledaily.com.cn/90001/90778/90859/7393658.html.*

[xxvii] *Carlyle Group:* In 2010, CIC helped refinance a Manhattan, NY, office tower co-owned by Carlyle Group. In 2008, China International Capital Corporation (CICC) partnered with Carlyle to invest US$35 million in Shenzhen Aohua Medical Services Co. Ltd. SAFE is also reported to have planned to invest in funds managed by Carlyle. Bloomberg, "CIC Backs Carlyle's Manhattan Tower in U.S. Push," January 4, 2011. *http://www.bloomberg.com/news/2011-01-03/cic-backs-manhattan-tower-as-china-steps-up-u-s-real-estate-investments.html*; *Asia Private Equity Review*, "China's Institutional Investors are Buying Home Assets," February 1, 2009, via Factiva; *Greater China Private Equity Review Daily*, "China's SAFE Invests in Blackstone Real Estate Fund," July 27, 2012, via Factiva.

[xxviii] *CDH Investments:* In 2008, NSSF allocated RMB 2 billion US$288.1 million to a fund managed by CDH. In the same year, investment bank CICC teamed up with the firm to invest US$44 million in Hong Kong-listed South Beauty Catering Management Group. *Asia Private Equity Review*, "China's Institutional Investors are Buying Home Assets," February 1, 2009, via Factiva.

[xxix] *Blackstone Group:* In June 2009, CIC invested over US$500 million in a Blackstone hedge fund unit. In July 2012, SAFE committed $500 million to a Blackstone property fund as part of its plan to allocate 5 percent of reserves in alternative investments. Bloomberg, "CIC Said to Invest $500 Million in Hedge Funds, Blackstone," June 19, 2009. *http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aEyh5EUNjlbo*; *Wall Street Journal*, "China Invests $500 Million in Blackstone Fund," July 26, 2012. *http://online.wsj.com/article/SB10000872396390443477104577550574246215012.html.*

Section 3: CIC as a Strategic Investor

As state-sponsored entities, SWFs are answerable to governments rather than private individuals. The inherent risk is that SWFs will pursue noncommercial objectives to further the strategic interests of their sponsoring government. When USCC Commissioners met with Gao Xiqing, CIC's president, in the spring of 2008, Mr. Gao stated unequivocally that CIC is operating on a commercial basis.[64] As this section demonstrates, however, CIC has also pursued strategic objectives as part of China's "go global" policy.

Coordinated Investment in Strategic Sectors

CIC has made strategic investments both upstream, in resources, and downstream, in utilities and logistics. These investments are targeted at areas in which China's economy has structural weaknesses. Most of these transactions occurred in 2009, when CIC had very strong cash flow and focused its investments on commodities. In many cases, there is evidence of coordination with other Chinese enterprises.

Oil and Gas

On the upstream side, CIC has aimed to mitigate China's growing dependence on resource imports. One example is the oil and gas sector. China imports about three-fifths of its oil, and at the end of 2012 overtook the United States as the world's leading (net) importer.[65] China is now importing more oil at a higher per-unit cost, placing a serious strain on Chinese industries dependent on petrochemicals. One countermeasure by the government has been to encourage China's national oil companies to boost equity oil production overseas in order to reduce exposure to price volatility and to profit from improved terms of trade.[66]

In September 2009, CIC took a 45 percent interest in Russia's state-owned Nobel Oil Group. Although the shares purchased were worth only $100 million, CIC paid an additional $150 million to acquire and develop Nobel's oilfields in Russia. Two Chinese firms based in Hong Kong – Oriental Patron Financial Group and Kaishun Energy – joined CIC and bought shares in Nobel to bring the Chinese stake to 50 percent.[67] This investment took place just seven months after China National Petroleum Corporation (CNPC), one of China's oil majors, extended a long-term, $25 billion loan to Russia in exchange for 300 million tons of oil piped from Russia's largest oil producer.[68]

CIC has also played a strategic role in the natural gas sector. Gas is not only a cleaner alternative to oil but has also become more cost competitive and transportable, thanks to technological advances in liquefaction and fracking. Although China's demand for natural gas is expected to double in 2009-15, China currently holds just 1.5 percent of the world's proven reserves.[69]

In September 2009, CIC purchased an 11 percent stake in JSC KazMunaiGas Exploration Production, the largest natural gas producer in neighboring Kazakhstan.[70] The deal was relevant when considering China's expanding energy partnership with Kazakhstan. CNPC is a part owner of five Kazakh oilfields, two exploration projects, and multiple pipelines. The Kazakh-China Oil Pipeline was a joint investment between CNPC and KazMunaiGas that became operational in July 2006. CNPC has also purchased a stake in another Kazakh gas company, Mangistai Munai Gas.[71] In April 2009, CNPC and China-Exim Bank lent a combined $10 billion to secure oil and gas assets in Kazahkstan, very similar to China's deal with Russia.[72]

CIC subsequently set its sights on prominent gas companies in the United States. In 2010, it invested $200 million in Chesapeake Energy, the U.S.'s second-largest gas producer. Soon afterward, China's oil majors China National Offshore Oil Corporation (CNOOC) and China Petroleum and Chemical Corporation (Sinopec) made multibillion-dollar investments in gas fields operated by Chesapeake in Texas, Colorado, and Oklahoma.[73]

In August 2012, CIC contributed $500 million to construct an LNG production and export terminal in Louisiana, run by a subsidiary of the U.S. firm Cheniere Energy.[74] Four months later, Cheniere entered into a sales agreement with the North American subsidiary of Total SA, a French multinational oil and gas giant, to ship oil from the Louisiana terminal to Asia. It is worth noting that Chinese SWF SAFEIC purchased a 1.6 percent stake in Total back in 2008.[75] Total proceeded to sign LNG supply contracts with China's national oil companies, CNOOC, Petrochina, and Sinopec, and by 2012, accounted for one-tenth of China's LNG imports.[76]

Outside the United States, CIC's largest investment in the gas sector was a $4.2 billion, 30 percent interest in the exploration and production subsidiary of France's GDF Suez. The August 2011 deal included a 10 percent stake in a liquefaction facility operated by Atlantic LNG, one of the world's largest LNG producers. The two parties also launched a long-term strategic partnership. Like Total SA, GDF Suez is becoming a key LNG supplier to China's leading oil and gas companies. Just three months after initiating its partnership with CIC, GDF Suez was contracted to sell 2.6 million tons annually to CNOOC, starting from 2013. According to the agreement, GDF Suez will also provide CNOOC with a floating storage and regasification unit. This sequence of deals suggests that CIC is helping finance LNG production by GDF Suez, and this production in turn is sold to CNOOC.[77]

Mining

Another example of CIC's strategic investment is the mining sector. While China has major reserves of iron ore, these are of poor quality and hard to access. Propelled by a booming steel industry, China by 2008 accounted for three-fifths of world iron ore imports.[78] A major concern is bargaining leverage, because hundreds of steel mills in China buy iron ore, while an oligopoly of three companies – Vale do Rio Doce, Rio Tinto, and BHP Billiton – accounts for 60 percent of the global iron ore trade.[xxx] In other important metals, like copper and bauxite, China also depends on imports from a select few large mining companies.

More recently, CIC has also become a net importer of coal. Although China is the world leader in coal production and reserves, coal accounts for two-thirds of the country's energy consumption, and demand is concentrated in China's coastal regions, far from the coal mining sites further inland. Rail infrastructure suitable for transporting coal is underdeveloped, making it difficult and costly to transport domestically extracted coal to coastal cities. That makes it attractive to import coal via China's large, modern seaports.[79]

Growing reliance on imports has prompted Chinese producers to invest in mining assets overseas, and CIC has joined in these efforts. In July 2009, the fund spent $1.5 billion to become the top shareholder of Teck Resources, Canada's largest independent mining company. Teck's major products include copper, steelmaking coal (coke), and zinc, and it relies on business with China for

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[xxx] For a detailed study, see Regina M. Abrami and Iacob Koch-Weser. "Heavy Metal (A): Baosteel Enters Brazil," Harvard Business School Case 912-411, May 2012. (Revised from original December 2011 version.)

a quarter of its total revenue.[80] Teck has been eager to expand its business in China following the investment, and in its 2009 annual report stated that "China is an important market for our businesses and we look forward to the opportunity to work with [CIC] to strengthen our position in that market for our mutual benefit." CIC's investment has allowed Teck to advance business with Chinese companies such as Jiangxi Copper Co., China's largest integrated copper producer, which was reported to be one of Teck's largest clients, importing over 60,000 tons of copper ore concentrates from Teck's copper mine in Chile.[81] Teck has also recently established an office in Shanghai to further strengthen business ties in China.[82]

Further, the Teck acquisition laid the groundwork for CIC's inroads into Canada, as the fund established its first overseas representative office in Toronto soon afterward. Marcia Smith, a Teck vice president, stated that CIC's investment in Teck would bring the companies mutual deal opportunities.[83] Just months after the Teck acquisition, CIC bought a $500 million, 13 percent stake in another Canadian firm, SouthGobi Resources Ltd., which specializes in coal production and development in Mongolia, from where coal products are shipped across the border into China. [84]

In the fall of 2009, CIC extended a six-year, $1.9 billion loan to Indonesia's largest coal producer, PT Bumi Resources. Indonesia is China's largest coal supplier in the Asia-Pacific region.[85] The loan was aimed not only at capital investments to expand Bumi's mining infrastructure but also at helping Bumi to service its debt during a market downturn. [86] In 2012, PT Bumi posted a net loss of $666 million due to a drop in coal prices and threatened to default on its debt payments to both CIC and several foreign banks, including J.P. Morgan and Bank of America Merrill Lynch. [87] One of the creditors that helped the Indonesian firm refinance its debt was CDB, the Chinese policy bank, which provided a $600 million loan.[88] Given its part ownership of CDB, CIC may have contributed indirectly to the bailout of PT Bumi.

In Australia, CIC also came close to negotiating a politically sensitive mining deal. The fund reportedly joined Chinese state-owned mining company Shenhua Energy in 2009 to negotiate a $3 billion equity investment in Fortescue, Australia's third-largest iron miner. Hunan Valin, a provincial steel producer in China, owns a 17.5 percent stake in Fortescue, and Shanghai Baosteel, China's largest steel producer, also operates a joint venture with the firm. Although the negotiations did not materialize, CIC's intention was in all likelihood strategic.[89] The negotiations came on the heels of a failed share acquisition of Rio Tinto, Fortescue's larger Australian competitor, by a Chinese steel company. Rio Tinto's China office chief Stern Hu was also arrested at the time on allegations of espionage.[90]

CIC has engaged as well with foreign financial institutions to acquire equity in mining producers. In December 2011, it bought a 25 percent interest in Shanduka Group, a South African investment holdings company that owns and controls businesses in the resource sector. CIC was granted representation in the Shanduka management and currently has two seats on Shanduka's board of directors. Following CIC's investment, Shanduka Group undertook sizable resource transactions, including the acquisition of a controlling stake in Shanduka Coal, which owns numerous coal mines located throughout South Africa.[91]

Utilities and Logistics

A final example of strategic investment is in logistics and utilities, downstream industries that are indirectly related to energy and resources.

China's utilities are in the process of upgrading power generation and distribution capacity in order to generate power more cleanly, efficiently, and farther from urban centers. Notably, the United States has been supportive of China in these efforts. In 2009, Duke Energy, the largest power company in the United States, began cooperating with Huaneng Group, one of China's "Big Five" utilities, to develop clean energy technologies.[92] China has also become the world leader in installed wind power capacity, although many wind farms are not properly connected to the power grid.[xxxi]

In November 2009, CIC invested $1.6 billion for a 15 percent stake in U.S. utility company AES Corporation. CIC was keen on joining a global company such as AES, which has an installed power capacity over 40,000 megawatts (MW) and over 132 power generation facilities in 29 countries.[93] AES also has a lengthy track record in the Chinese energy market. AES set up its Chinese subsidiary in 1994; Paul Hanrahan, the AES chief executive officer in 2009, had run the Chinese unit when it was first established. By 2009, AES had seven operating facilities in China.

AES' power-generating capacity in China is moderate, accounting for just over 6 percent of AES' global installed power capacity in 2010.[94] Of greater interest to CIC at the time of the acquisition was AES' leading role in China's clean energy sector. In the early 2000s, the U.S. firm shifted from operating fossil fuel power plants in China to developing wind farms, effectively becoming an intermediary between Chinese turbine makers and Chinese utility companies. Sinovel, China's second-largest wind turbine maker, became AES' supplier of choice, ahead of foreign manufacturers like General Electric and Vestas.[95] Under its initial agreement with CIC, AES was going to sell the SWF an additional 35 percent stake in its wind-generation business.[96] AES at the time had 1,200 MW of new wind projects that would require $600 million in equity over 18 months. AES was hoping to use some of this capital in order to finance exports of Chinese-made turbines for its wind farms in Vietnam.[97]

CIC ultimately opted not to purchase the stake in the AES wind power business. And yet, it did help AES find other Chinese partners. In February 2012, State Grid Corp., China's largest utility company, took an 80 percent stake in the AES wind power business. The investment formed part of State Grid's foray into international markets, including the acquisition of power grids in Brazil and a privatized utility company in Portugal.[98]

In logistics, CIC has made two notable investments. In September 2009, it purchased an $850 million, 14.9 percent stake in Noble Group Ltd., a Hong Kong-based global supply chain manager of agricultural, industrial, and energy products. Noble holds about $300 billion worth of assets and is one of the main companies shipping commodities, such as soybeans, from Latin America to China. In 2011, CIC also began to partner with Global Logistic Properties Limited (GLP), a company that owns and leases modern logistics facilities across China and Japan. In November 2012, CIC participated in GLP's expansion into logistics facilities in Brazil, the premier commodity exporter to China in the Latin America region. CIC did so by acquiring a $460 million, 34.2 percent stake in a joint venture alongside Canada Pension Plan Investment Board and Government Investment Corp., one of Singapore's SWFs.[99]

[xxxi] For details, see Regina M. Abrami and Iacob Koch-Weser, "Goldwind USA: Chinese Wind in the Americas." Harvard Business School Case 912-416, May 2012.

CIC as an Active Investor

Besides the allocation and coordination of investment, CIC has also been strategic in its choice of governance models. SWFs tend to act as silent partners who put up capital but have little influence on execution, terms, or future strategy. Few SWFs have the infrastructure and inclination to actively participate in the management of businesses.[100] In response to concerns about CIC taking controlling stakes in its investments, CIC President Gao told USCC Commissioners in 2008 that the fund does not want board seats and has instructions to take passive roles in its investments.[101]

However, CIC has gained influence on the boards of four companies in which it has acquired a stake of 10 percent or more. In 2010, Felix Chee, an adviser to CIC's chief investment officer, was appointed to the board of Teck Resources. Mr. Chee is a Canadian of Chinese descent who spent most of his career in Canada’s financial services industry. He helped put the Teck deal together, and around the time of joining Teck’s board, he was busy establishing CIC’s first overseas representative office in Toronto.[102]

In December 2011, CIC was also granted the right to appoint one member to the board of AES. The person chosen was not from within CIC; rather, it was a high-level Chinese government official, Zhang Guobao, who served as vice chairman of the NDRC, China’s premier planning agency. Before joining NDRC, Mr. Zhang had held the position of administrator of the Chinese National Energy Administration, a powerful new body in charge of energy policy.[103]

Table 3-1: CIC Affiliated Positions in Management

Company	CIC stake	Country	Board member	Position	Year appointed
Teck Resources	17.2%	Canada	Felix Chee, Special Advisor	Adviser to CIC's chief investment officer	2010
AES	15.0%	USA	Zhang Guobao, Director	Vice chairman of the Chinese National Development and Reform Commission and recently held the position of administrator (Minister-level) of the Chinese National Energy Administration	2011
Shanduka Group	25.1%	South Africa	Wang Hui, Nonexecutive Director	Director of the Head of the Metals and Mining Team of the Special Investments Department of CIC	2012
			Hu Bing, Nonexecutive Director	Managing director, head of Special Investments Department of CIC	
Heathrow Ltd.	10.0%	Britain	Zhang Qing (King), Nonexecutive Director	Managing director of the Special Investments Department at CIC	2013

Sources: Teck Resource, AES, Shanduka Group, Heathrow Ltd.

Cooperation with Other SWFs

CIC has participated in China’s economic diplomacy through cooperation with other SWFs. Two notable examples are Singapore and Russia.

CIC officials have indicated that Singapore's SWFs have served as models for their own fund. Moreover, China International Capital Corporation (CICC), one of China's largest investment banking and research services companies, founded in 1995, counts Singapore's SWF GIC among its shareholders.[104] Temasek, the Singaporean SWF, has also purchased the Hong Kong-listed shares of China's major commercial banks – the same banks in which Central Huijin is the major shareholder.[105]

Further, in several cases, CIC and Singapore's SWFs have transacted with the same companies overseas. One example is the U.S. gas sector, where CIC invested in Chesapeake Energy and Cheniere Energy alongside Singapore's SWFs. Chesapeake issued $900 million in convertible preferred stock, which was purchased by CIC, Korea Investment Corporation, and Singapore's Temasek.[106] Like CIC, Singapore's GIC contributed $500 million to the construction of Cheniere's new LNG production and export platform in Louisiana. Prior to this, Cheniere had attracted investment from Temasek as well.[107] In the logistics sector, GIC joined CIC in supporting the expansion of Global Logistics Properties into Latin America.[108]

In contrast to Singapore, CIC's cooperation with Russia is explicit and carries stronger political overtones. In the wake of the global financial crisis, many foreign investors left Russia, and global gas prices fell, putting immense pressure on Russia's balance of payments. In September 2010, Russian Finance Minister Alexei Kudrin announced that the government was preparing to sell $10 billion worth of state-owned assets per year for approximately five years. Nine months later, Moscow founded the Russian Direct Investment Fund (RDIF), a private equity vehicle under Russia's state-owned bank Vnesheconombank (VEB). RDIF's principal aim is to counteract the sharp drop in Russia's FDI inflows by courting foreign investors, both sovereign and private. RDIF is mandated to secure co-investment that as a minimum matches Russia's own commitment.[109]

CIC became the first foreign investor to commit to RDIF, doing so through the creation of a Russia-China Investment Fund (RCIF). RCIF effectively became a subsidiary of RDIF, taking the form of a limited partnership. The initial agreement was made in October 2011 during a visit by Russian Prime Minister Vladimir Putin to Beijing and was officially launched at a signing ceremony in Beijing in June 2012. The Russians matched CIC's contribution of $1 billion.[110]

It is questionable whether CIC's investment in RCIF was only commercially motivated. The deal came just after Presidents Hu and Putin had failed to conclude sensitive talks about planned gas pipelines before President Hu's state visit to Moscow in June 2012, owing to price disputes between Russia's OAO Gazprom and CNPC. Some analysts argue that the deal serves as a way to diversify Russia and China's bilateral investment beyond the oil and gas sectors. RCIF's stated focus is on higher value-added industries like engineering, agriculture, commodity processing, and transport infrastructure in Russia, which would use Chinese technology and contractors.[111]

The strategic role of CIC in Sino-Russian diplomacy was further evidenced in February 2013, when CIC invested in the initial public offering (IPO) of the Moscow Exchange. The IPO raised $499 million, including $80 million from RDIF and a further $200 million from other direct investors. According to one source, CIC at least matched the RDIF investment.[112] This transaction appears to have had little commercial value for CIC, which has avoided equity investments in financial services companies since 2010.

Financial Support for Chinese Enterprises

A final form of strategic behavior has been CIC's direct financial support for Chinese enterprises. One way in which the fund has done this is through its domestic subsidiary Central Huijin. As discussed in Section 2, CIC acts as a shareholder of China's largest financial institutions, and these in turn are the creditors of major Chinese enterprises. Central Huijin has also circumvented the banks it owns to provide capital directly to enterprises.[xxxii] For example, it has taken a majority stake in China Reinsurance (Group) Corporation and a minority interest in the Internet service company Alibaba.[113]

A second form of support for Chinese enterprises is through CIC's other subsidiary, CIC International. It has taken equity stakes in Chinese firms listed in Hong Kong and other international exchanges. Share purchases include $100 million in China Railway Group (2007); $400 million in Longyuan Power Group (2009); $710 million in GCL Poly (Hong Kong) Energy Ltd. (2009); $816 million in Changsha Heavy Industry (2010); and $250 million in Semiconductor Manufacturing International Corporation (SMIC) (2011).[114] The firms are generally state-owned and belong to China's pillar industries – transport logistics, heavy industry, and power generation. Issuing public shares has been a common strategy for these firms to raise capital, but investors often lack confidence in the profitability of recently restructured SOEs. In the wake of the global financial crisis, the stock market has also been lackluster. Presumably, CIC purchased shares in order to buoy the companies' share prices.

The investment in GCL-Poly Hong Kong suggests more strategic motives. Poly-Hong Kong is the subsidiary of China Poly Group Corp., a business group that operates in dozens of industries in China. According to a groundbreaking report by Bloomberg published in 2012, the group is operated by the son of a Chinese revolutionary general and has close links to other members of the leadership.[xxxiii] In 2009, CIC became the second-largest shareholder of GCL Poly (Hong Kong) Energy Ltd., China's largest producer of polysilicon, a chemical material that is used for solar panels and other industrial applications. The two sides also agreed to set up an additional joint venture company with registered capital of $500 million to invest in solar power projects, in which GCL would own the 51 percent majority stake.[115] Further, also in 2009, CIC purchased a $53 million, 2.3 percent stake in Poly (Hong Kong) Investments Ltd., the offshore property flagship of Poly Group. At the time of the CIC acquisition, Poly-Hong Kong owned some 9.4 million square meters of real estate in over a dozen Chinese cities.[116]

[xxxii] According to a 2005 estimate, 70 percent of new loans originating from state-owned banks in China are granted to state-owned enterprises. Michael F. Martin, "China's Banking System: Issues for Congress" (Washington, DC: Congressional Research Service February 10, 2012), p.40. *http://www.fas.org/sgp/crs/row/R42380.pdf*.

[xxxiii] According to Bloomberg, GCL Poly was founded by Wang Jun, the son of a famous Chinese general. The company initially sold weapons to Iran, Burma, and Pakistan in the 1980s and then expanded into various other industries, including coal mines, real estate, movie theaters, and travel televisions. As Bloomberg has shown, relatives of China's Eight Immortal revolutionaries have an interest in the company. Bloomberg, "Heirs of Mao's Comrades Rise as New Capitalist Nobility," December 26, 2012. *http://www.bloomberg.com/news/2012-12-26/immortals-beget-china-capitalism-from-citic-to-godfather-of-golf.html.*

Section 4: CIC Governance

Enhanced Transparency and Accountability

Since the USCC held its hearing on China's SWFs in 2008, international regulation and monitoring of SWFs has improved in many areas. The International Working Group of Sovereign Wealth Funds (IWG), established by the International Monetary Fund, has set out Generally Accepted Principles and Practices (GAPP), commonly referred to as the "Santiago Principles." The Santiago Principles' stated aim is to "promote a clearer understanding of the institutional framework, governance, and investment operations of SWFs in order to facilitate free-flowing international investment."[117, xxxiv] SWFs sign on to the principles voluntarily. Their compliance is monitored, albeit not subject to any hard enforcement.

The Santiago Principles have also spawned corollary efforts to make SWFs more accountable. The Sovereign Wealth Fund Initiative, headquartered at Tufts University in Boston, conducts research and convenes managers of SWFs with policymakers and businesses. The IMF's International Forum of Sovereign Wealth Funds (IFSWF) meets at least once a year to exchange views on issues of common interest to SWFs and to facilitate an understanding of the Santiago Principles. In addition, private institutes have published their own assessments of SWF governance. Edwin M. Truman, senior fellow at the Peterson Institute for International Economics in Washington, DC, developed the so-called Truman Scoreboard, an independent, periodic assessment of SWFs based on quantifiable metrics.[118] A similar rating method, the Linaburg-Maduell Transparency Index (LMTI), was developed by the Sovereign Wealth Fund Institute (SWFI).[xxxv]

Initially, CIC was reluctant to increase transparency. In an interview with CBS Television's *60 Minutes* in early 2008, CIC President Gao Xiqing pledged that CIC is "going to do things" to be as open as Norway's SWF, considered to be one of the world's most transparent; yet he stated that the Santiago Principles "will only hurt feelings" and are neither economically nor politically useful. [119] CIC was not alone in its reluctance to become more transparent – as wealthy economies suffered during the global financial crisis, many SWFs, especially those in the Gulf States, felt they had significant leverage to resist tighter regulation and still obtain market access.[120]

However, CIC eventually shifted course, going so far as to participate in the drafting of the Santiago Principles in September 2008. The Chinese government officially endorsed the principles upon their promulgation by the IWG in October that year.[121] A possible explanation for this change in attitude is that leading SWFs, including in Norway and Singapore, agreed to higher transparency standards first, placing pressure on CIC to do the same.[xxxvi] China became even more proactive in

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[xxxiv] The principles are divided into three pillars: (i) Legal Framework, Objectives, and Macroeconomic Linkages (Principles 1-5); (ii) Institutional Framework and Governance Structure (Principles 6-17); (iii) Investment and Risk Management Framework (Principles 18-24).

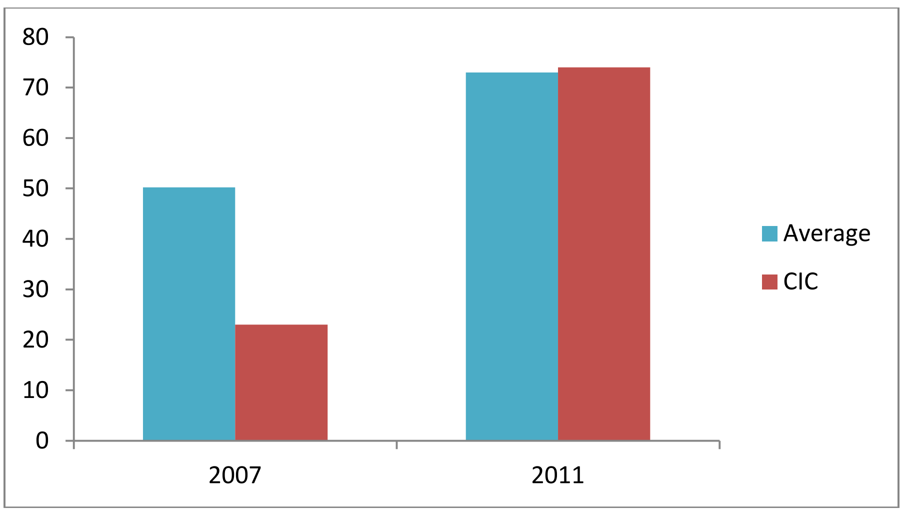
[xxxv] The Linaburg-Maduell Transparency Index is based on ten essential principles that depict sovereign wealth fund transparency to the public. The index ranges from 1 to 10, with 10 being the most transparent. The principles used to assess the SWFs include information about creation, origins of wealth, and government ownership structure; audited annual reports; ownership percentage of company holdings; total portfolio value; clear strategies and objectives; information about subsidiaries and external managers; and ethical standards. *http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/*.

[xxxvi] According to Ted Truman of the Peterson Institute, the GAPP negotiations made progress because countries with SWFs were a fragmented interest group, constituting a mix of developing, middle-income, and advanced countries. Daniel W. Drezner, a noted China expert, has argued that, while countries with SWFs

2011, hosting the third meeting of the IFSWF, at which China's then Vice Premier Li Keqiang spoke. The forum resulted in the Beijing Declaration, by which SWFs agreed to establish a permanent secretariat in the IMF to oversee the regulation of SWFs and their commitments under the Santiago Principles. Jin Liqun, who served as chairman of CIC's board of supervisors until March 2013, was elected to chair the IFSWF.[122]

In terms of compliance, CIC has not been outstanding but has certainly outperformed many other SWFs, particularly in the Gulf States. CIC published its first annual report in July 2009 and has since provided significant detail on its holdings and financial accounts, including annual returns on its outbound portfolio. In contrast, Singapore's GIC only began to report five-year and ten-year annualized returns in July 2011.[123] Moreover, CIC has scored fairly well in independent surveys: it ranks twenty-third among 48 SWFs surveyed in the SWFI's latest LMTI score and eleventh out of 34 SWFs on the Truman Scoreboard.

Figure 4-1: Truman Scores, 2011



Note: Final scores given to individual SWFs range from 0-100, with 100 representing full compliance.
Sources: Sarah Bagnall and Edwin M. Truman, *IFSWF Report on Compliance with the Santiago Principles: Admirable but Flawed Transparency* (Washington, DC: Peterson Institute for International Economics, August 2011), p. 2; Edwin M. Truman, *Sovereign Wealth Funds: Is Asia Different?* (Washington, DC: Peterson Institute for International Economics, June 2011), p. 24.

In July 2009, the same month that it published its first annual report, CIC also held the inaugural meeting of its International Advisory Council.[124] The Council was modeled after similar bodies at SWFs in Singapore and Norway. In CIC's case, it is composed of 15 advisors and one secretariat. It has four U.S. advisors:

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formed a fragmented interest group, advanced economies who received their investments shared common interests, and were thus able to demand tougher rules under the aegis of the IMF. The Sovereign Wealth Fund Initiative, "A Conversation with Ted Truman, Senior Fellow, Peterson Institute for International Economics," March 2012; Daniel W. Drezner, "Bad Debts: Assessing China's Financial Influence in Great Power Politics," *International Security* 34:2 (Fall 2009): 28-31.

- *Merit E. Janow.* Professor of International Economic Law and International Affairs, Columbia University; Chairman, NASDAQ Stock Market LLC; former member of the Appellate Body of the WTO.
- *John L. Thornton*. Professor and director of Global Leadership at Tsinghua University in Beijing; Chairman of the board of trustees at The Brookings Institution; Co-chairman, Barrick Gold Corporation; Nonexecutive chairman of HSBC North America; former president of Goldman Sachs Group.
- *James D. Wolfensohn.* – Chairman of Wolfensohn & Company; former president of the World Bank Group; former chairman of the Citigroup International Advisory Board.
- *John J. Mack.* Chairman emeritus, former chief executive officer of Morgan Stanley.[xxxvii]

Problems with CIC's Governance

Personnel and Organization

Although CIC has made efforts to improve transparency, an underlying concern remains its close relationship with the Chinese government. SWFs are generally quasi-independent entities with low levels of government interference. It is not uncommon for government officials to retain board representation, but their presence is usually balanced by professionals who are hired on a meritocratic basis.[125]

CIC, in contrast, maintains very close ties to the state. Of the 25 individuals staffing CIC's board of supervisors, board of directors, and executive committee, only three individuals are not current or former government officials: Vice President Wang Jianxi, who spent many years on Wall Street; Chief Strategy Officer Zhou Yuan, the former vice chair of the Hong Kong Mercantile Exchange; and Chief Information Technology Officer Hua Hua, who was the former vice president of Great Wall Software International Ltd., a government-sponsored information technology (IT) firm. [126]

CIC's mandate requires that five government agencies be represented on its board. One of the agencies represented is the NDRC, a superministry in charge of industrial planning that has little to do with monetary policy. In 2007-12, an NDRC official served as nonexecutive director, while a former NDRC official was chief risk officer. Moreover, in 2009, CIC appointed Li Keping, the head of China's social security fund, NSSF, to become CIC's chief investment officer. Mr. Li's success at NSSF may have merited the appointment, yet it further deepened CIC's ties to the state.[127] Also on CIC's board are former heads of the Bank of Communications, China Construction Bank, and the Export-Import Bank. Through its subsidiary Central Huijin, CIC owns equity in all of these financial institutions. [128]

Furthermore, the leadership transitions at CIC suggest a "revolving door" among top government agencies. It is common practice at SWFs to allow top managers to stay on for many years in order to provide continuity and to oversee investments with long time horizons.[129] That does not appear to be the case at CIC, which in 2013 became enmeshed in China's once-in-a-decade leadership transition. CIC Chairman Lou was appointed Minister of Finance, essentially returning to his former employer, where he had served as vice minister until 2007. As yet, no successor has been named to

[xxxvii] Remaining international advisors are Zeng Peiyan (China), Shaukat Aziz (Pakistan), Frederick Ma (Hong Kong, China), Taizo Nishimuro (Japan), Yingyi Qian (China), Andrew Sheng (Malaysia), Joseph Yan (Hong Kong, China), Omari Issa (Tanzania), Knut N. Kjaer (Norway), Jean Lemierre (France), and Lord Nicholas H. Stern (United Kingdom). China Investment Corporation, *2011 Annual Report* (Beijing, China: July 2012), p.17.

head the fund. CIC is an anomaly, as Beijing's other top finance jobs – head of the central bank, China Development Bank, and the four largest commercial banks –were all filled.[130]

In April 2013, Tu Guangshao, the former vice mayor of Shanghai and veteran financial services regulator at the PBOC and the CSRC, was reported to become Chairman Lou's successor. It was later revealed that he was not interested in the post. Yi Gang, deputy governor at the PBOC, also declined an offer for the chairmanship.[131] Eyes have turned to CIC Vice Chairman and President Gao Xiqing, who has temporarily taken leadership of CIC in Chairman Lou's absence. Although qualified, Mr. Gao is not being considered because he is a Wall Street veteran who lacks Communist Party credentials, according to sources familiar with the situation.[132]

Despite the uncertainty of who will become chairman, CIC did fill its other leadership post on the supervisory board. CIC Supervisory Board Chairman Jin Liqun left to became the head of China International Capital Corp., a quasi-government investment bank majority owned by CIC's subsidiary Central Huijin. Taking Mr. Jin's place at CIC was Li Xiaopeng, the vice head of the Industrial and Commercial Bank of China (ICBC).[xxxviii] ICBC is one of the commercial banks owned by Central Huijin.

Furthermore, CIC is required under China's Company Law to have a Communist Party committee. However, no mention is made of this committee in the fund's annual reports. Sources report that Chairman Lou served as the party secretary of the committee alongside his other duties. Executive directors Gao Xiqing and Hu Huaibang apparently served as vice secretaries in the committee.[133] CIC's new chairman will likely take the lead in the committee.

The presence of Chinese Communist Party officials on CIC's boards raises questions about the fund's compliance with the Santiago Principles. GAPP 16 calls for public disclosure of operational independence between management and the shareholder. CIC states that it is operationally independent from its shareholder, the State Council. However, as CIC's management is comprised of government officials who have direct or indirect relationships with the leadership of the State Council, it is difficult to adequately determine CIC's independence from political influence when making important decisions.

Auditing and Disclosure of Domestic Investment Performance

Financial auditing is a subtle but vital area in which CIC's transparency and accountability are at risk. The Santiago Principles (GAPP 12) recommend that SWFs conduct annual independent external audits.[134] A model for this is Norway's Government Pension Fund Global, which is currently audited by Deloitte, one of the "Big Four" international accounting firms.[135] However, CIC's "external auditor" is the China National Audit Office (CNAO), the Chinese government's supreme audit authority.[136] CNAO is a ministry directly under CIC's shareholder, the State Council.[137] CNAO's Deputy Auditor General Dong Dasheng also sits on CIC's board of supervisors.[138]

Due to its holdings in domestic financial institutions, managed by its subsidiary Central Huijin, CIC potentially falls short of meeting the recommendations of other GAPP principles. GAPP 17, for instance, calls for public disclosure of relevant financial information, including asset allocation, relevant benchmarks, and rates of return. Although CIC provides some financial information in

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[xxxviii] Jane Cai and Daniel Ren, "Shanghai Vice-Mayor Set for China Investment Corp," *South China Morning Post*, May 11, 2013. *http://www.scmp.com/business/banking-finance/article/1234975/shanghai-vice-mayor-set-cic.*

greater detail than other SWFs, it does not include performance measures, such as annual returns, for its domestic portfolio. In August 2010, Central Huijin released a financial report covering the period between 2007 and 2009, part of disclosure rules for an issuance of RMB 160 billion worth of bonds on the interbank market.[139] Currently, however, the performance of CIC's domestic assets can only be extrapolated from the fund's overall investment returns, which include both domestic and outbound investment, and from the growth of the asset class known as "long-term equity," which connotes CIC's long-term domestic holdings under Central Huijin.

Regulatory Gaps in the International System

While assessing compliance with existing rules and norms, it is also important to recognize regulatory gaps in the international system. One gap is that the Santiago Principles are nonenforceable. Consequently, guidelines and policies are only as good as the commitment of the signatories. In the absence of private shareholders, the main incentive for CIC and other SWFs to abide by rules and norms is to improve perceptions in recipient countries. But this incentive may diminish as SWFs become more influential.

A second concern is that the Santiago Principles have not expanded to cover more SWFs. In China, no SWF other than CIC has signed on. Part of the problem is definitional – the framers of Santiago essentially concur with the Chinese government that CIC is the only fund that qualifies as an SWF.

Table 4-1: Transparency of China's SWFs (LMTI System)

SWF	LMTI	Rank
China Investment Corporation (CIC)	7	23rd
National Social Security Fund (NSSF)	5	31st
SAFE Investment Company (SAFEIC)	4	34th
China-Africa Development (CAD) Fund	4	38th

Note: Rankings are deduced from a list of the world's 48 largest SWFs. Ratings given to SWFs are based on a point system of 1-10 determined by essential principles that depict transparency, with a score of 1 representing complete opaqueness and 10 representing complete transparency. The Sovereign Wealth Fund Institute recommends a minimum rating of 8 in order to claim adequate transparency.
Source: Sovereign Wealth Fund Institute, *4th Quarter 2012 LMTI ratings* (Las Vegas, NV), http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index.

Perhaps not surprisingly, China's other SWFs rank lower than CIC in standard governance scores. Of particular concern is SAFE, which has direct access to China's foreign exchange reserves. Although SAFE does publish an annual report, it does not provide detail on the activities of SAFEIC. That has left market analysts puzzled about which investments it has made and how. The *Financial Times* noted in 2008 that "several company representatives [in Hong Kong] confirmed that they were aware of the stakes held by Safe Investment Company but could not confirm the nature of the shareholding entity. The paper trail has been confused by various methods and names for purchasing stakes."[140] The only way the *Wall Street Journal* was able to trace SAFEIC's investments in the United Kingdom was by looking at property deals and at disclosures by the companies that received the investments.[141] SAFE has also been reluctant to disclose details on its internal organization. It took until 2007 for it to confirm the existence of SAFEIC, even though this Hong Kong-based foreign investment arm was already created in 1997.[142] Similarly, SAFE took several months to confirm the existence of a new Co-Finance Office, established in 2011 to support China's outbound investors.[143]

Another loophole in international regulation relates to the entities that SWFs collaborate with. Failure to adequately regulate these actors has an indirect impact on the transparency of SWFs. Of particular concern is the "shadow banking" system, in which financial intermediaries do not accept traditional bank deposits, and thus are not subject to traditional banking regulations. Examples include hedge funds, unlisted derivatives, and other financial instruments not subject to regulatory oversight. According to one scholar, more information is known about the portfolio holdings of SWFs than large, private financial institutions, which have less reason to be concerned about public perceptions.[144] Although SWF managers have complained about receiving more scrutiny than hedge funds and other managers, there is also the potential for them to use external fund managers to make strategic investments in an opaque manner. CIC, which manages 57 percent of its portfolio through external managers,[145] has certainly resorted to this strategy, even if it began to manage more assets internally in 2010.

CIC also owns equity in and cooperates with China's state-owned enterprises and banks. A few years prior to the Santiago Principles, there were prospects for a binding international agreement on regulating state-owned enterprises to better reveal the nature of their operations and their ties to sovereign government interests.[146] At present, however, no such agreement has been implemented. Regulation of SWFs but not SOEs is especially problematic in China's case, where state actors are pervasive, and the divisions between them are blurred.

Section 5: Regulatory Responses in the United States

Over the past six years, China's SWFs have made major investments in the United States. CIC has become an active portfolio investor, pouring over $9 billion into 84 U.S.-traded public companies by the end of 2009, including brand names like Coca-Cola Company, Apple Inc., and Johnson & Johnson.[147] In addition, CIC has purchased larger interests in several U.S. companies, among them Blackstone, Morgan Stanley, and Blackrock in the financial sector, and AES in the energy sector. Although CIC has shifted more of its assets to other countries, the United States remains an important market.

The regulatory responses to CIC in the United States have been complex. As Robert H. Smith, business professor at the University of Maryland, told the USCC in 2008: "U.S. policy with regard to sovereign wealth is largely underdeveloped. It has to be discerned from a variety of laws and regulations."[148] Thus far, regulation of inbound investment from China's SWFs in the United States has been handled primarily by four agencies: the Federal Reserve (Fed) and the Securities and Exchange Commission (SEC) in the financial sector; the Committee on Foreign Investment in the United States (CFIUS) outside the financial sector; and Internal Revenue Service (IRS) tax regulations for foreign sovereign investors.

CFIUS Exon-Florio Reviews

In recent years, CFIUS has developed into a major tool for U.S. regulators to screen foreign investments that have national security implications. The committee was established by Congress under the Exon-Florio Amendment of the Omnibus Trade and Competitiveness Act of 1988, which was added to Section 721 of the 1950 Defense Production Act. Prior to 1988, investments could only be blocked if the president declared a national emergency or if regulators invoked federal antitrust, environmental, or securities laws. Under the new law, CFIUS, an interagency committee chaired by the Treasury, could screen foreign investments on national security grounds, while the president was granted the authority to block or suspend a foreign takeover of U.S. firms based on "credible evidence" that it may "impair the national security." Crucially for SWFs, the Byrd Amendment to the Exon-Florio statute in 1992 required CFIUS to investigate investments in which the investor is controlled by a foreign government.[149]

In 2007, the Foreign Investment and National Security Act of 2007 (FINSA) significantly expanded the scope and intensity of the Exon-Florio review process. As a result of FINSA, CFIUS has become much more active. In 2008-11, average notifications per year rose by 24 percent over 1988-2005. The share of notices investigated has increased from 2 percent to 23 percent.[150]

Chinese companies too have been subject to the Exon-Florio review process. In 2005, the proposed takeover of U.S. oil company Unocal by China's oil major CNOOC was opposed by certain Members of Congress. That factored into CNOOC's decision to withdraw the proposal. In 2008-11, after FINSA was introduced, CFIUS reviewed 26 investments by Chinese companies. In three cases, CFIUS contributed to blocking these investments.[151]

Through 2012, CIC has made half a dozen large investments in U.S. firms but has only been reviewed once by CFIUS. In 2007, FINSA sponsor Senator Chris Dodd (D-CT) sought information to see if CIC's acquisition of Morgan Stanley required a CFIUS review.[152] Yet by buying stakes below 10 percent, CIC was not subject to the review. The fund was counseled in the matter by U.S. law firm Sullivan & Cromwell LLP.[153]

The exceptional case was AES Corp. In 2009, CIC purchased a 15 percent stake in the U.S. energy firm, prompting a drawn-out, four-month CFIUS review process. During this period, CIC's then Chairman Lou urged Washington to relax scrutiny of Chinese government entities investing in the United States and to speed up deals that might help create jobs for Americans.[154] Eventually, however, CIC utilized the AES case to demonstrate that it was a "responsible investor." It enlisted the support of Covington & Burlington, the same U.S. law firm that represented CNOOC during its CFIUS approval process in 2005.[155] CFIUS eventually approved the investment in 2010.

Financial Sector Oversight

In the financial sector, CIC has come under more frequent review by U.S. regulators than it has in CFIUS. The SEC has been effective in getting CIC to disclose more information about its investments and operations. The regulator requires institutional investors to submit the form if they use the U.S. mail for business and exercise discretion over $100 million or more of "Section 13(f) securities". To date, CIC has made over 25 filings to the SEC. Most notably, in February 2010 a comprehensive list of CIC's holdings in U.S. publicly traded securities was made available to the public when it filed SEC Form 13F, a quarterly holdings report.[156]

CIC's 2010 filing did not include its entire stakes in the United States, such as its investment in Blackstone Group. But the filing was the first time CIC has disclosed the quantity and value of its holdings of U.S. publicly traded securities, which at the time totaled US$9.63 billion.[157] It revealed some of CIC's largest holdings: Teck Resources ($3.5 billion), Morgan Stanley ($1.8 billion), Blackrock ($714 million), and smaller stakes in companies like AIG ($14.3 million), and Apple ($6.3 million).

The 2010 filing was the only instance in which CIC has disclosed holdings of U.S. securities in such detail. The fund has not filed another Form 13F since then. Nonetheless, CIC has continually made other routine filings with the SEC regarding transfer of beneficial ownership, which includes Schedule 13D, a filing required of any investor that acquires over 5 percent ownership of a voting class of a company's equity securities.[158]

The Federal Reserve, for its part, has reviewed CIC in two areas: (1) CIC's proposed acquisition of interest in U.S.-based financial institutions; and (2) proposed transactions in the United States by Chinese commercial banks, which are indirectly controlled by CIC through its wholly owned subsidiary, Central Huijin. So far, four cases involving CIC have been reviewed and approved by the Fed:

- *Industrial and Commercial Bank of China* (August 2008). ICBC, the commercial bank owned by CIC subsidiary Central Huijin, won approval for a U.S. banking license.
- *Morgan Stanley* (August 2010). CIC was granted permission to convert its shares in Morgan Stanley, purchased in 2007, into voting shares.
- *Industrial and Commercial Bank of China* (May 2012). ICBC, in which Central Huijin has a 35.5 percent stake, won approval to buy an 80 percent stake in the U.S. operations of Bank of East Asia.
- *Bank of China* and *Agricultural Bank of China* (May 2012). Bank of China, in which Central Huijin has a 67.7 percent stake, and ABC, in which Central Huijin has a 40.2 percent stake, were granted permission to open branches in New York and Chicago.

In reviewing these cases, the primary question has been how CIC should be treated under the U.S. Bank Holding Company Act (BHCA). Under the BHCA, a bank holding company is not permitted to purchase more than 5 percent of the shares of any nonbanking company, whether in the United States or anywhere else. Further, a bank holding company must be reviewed in tandem with any investments by its subsidiaries and must fulfill regular reporting, filing, and capitalization requirements. The aim is to prevent "moral hazard" and unfair competition, such as lending by a bank to a firm controlled by the same parent.[xxxix] A bank holding company must also be reviewed in tandem with any regulatory review of the banks it controls. An entity is defined as a "bank holding company" if it influences the election of a majority of the bank's board members; owns 25 percent or more of its voting shares; or has the ability to exercise a "controlling influence" through management. [159]

When the BHCA was first enacted in 1956, it applied exclusively to domestic banks. In 1978, Congress passed the International Banking Act (IBA) to ensure that the BHCA applied equally to any foreign bank that operates a branch, agency, or commercial lending company in the United States, and any company that controls the foreign bank.[160] In 1988, the Fed's treatment of a state-owned Italian bank also set an important precedent by maintaining that legal entities established or controlled by foreign governments are "companies" for BHCA purposes. In 1991, the IBA was further amended to give the Fed stronger supervision and enforcement rights vis-à-vis foreign banks; in particular, the establishment of a U.S. branch by a foreign bank required Fed approval. [161]

If strictly enforced, the above regulations would put CIC in a difficult position. CIC's designation as a bank holding company would bar it from investing in nonbank assets, a practically inconceivable

[xxxix] Moral hazard occurs when a party to a transaction takes unusual risks in order to earn a profit, knowing that the costs of such a risk will be borne by another party.

restriction given the fund's existing holdings and planned investments in other sectors. On the other hand, if CIC were to engage in nonbanking activities, the Chinese banks it controls could be barred from doing business in the United States. The BHCA reporting requirements would also hamper CIC's decision-making and potentially force it and Central Huijin to disclose information about Chinese banks that is closely guarded by the Chinese government.[162]

However, in approving the U.S. activities of ICBC, BOC, and ABC, the Fed ultimately took a lenient approach. It not only approved the proposed transactions but also allowed CIC to go on for the most part with business as usual. The Fed made extensive use of Section 4(c)(9) of the BHCA, under which it has wide discretion to offer exemptions. In its approval of ICBC's banking license in autumn 2008, the Fed recognized both CIC and Central Huijin as bank holding companies. Yet in so doing, it did not place any restrictions on CIC's nonbank investments. In addition, the Fed largely exempted CIC and Central Huijin from the regular reporting, filing, and capitalization requirements of the BHCA.[163]

According to Robert Pozen, a professor at the Harvard Business School, Central Huijin extensively supported ICBC during and after the global financial crisis, indicating "significant involvement in ICBC's management of its finances."[164] Guo Li, a legal scholar at China's Tsinghua University, has noted: "Thanks to the Fed's conditional exemptions, the CIC invested with more autonomy in areas such as commodities, real estate, and infrastructure […] in addition to the financial sector."[165]

An analysis published by the Tufts Sovereign Wealth Fund Initiative further illustrated the exceptional nature of the exemption vis-à-vis other SWFs:

The upshot of the May 9, 2012 [ICBC] approval is that CIC and Huijin will now be able to register as bank holding companies. Until this time, other well publicized investments by sovereign wealth funds in foreign banks with US branches, and in US banks, have been specifically structured to avoid 'control' of a US bank, thereby avoiding having to register as a bank holding company under the BHC Act. For example, during the height of the financial crisis in 2008, Temasek Holdings (Private) Limited took great pains to structure its investment in Citigroup as non-controlling, thereby avoiding the need to seek FRB [Federal Reserve Bank] approval to become a bank holding company. In contrast, CIC and Huijin actually sought approval from the FRB to become bank holding companies as well as exemptions from limitations on non-banking activities available to foreign entities.[166]

The Fed did place some conditions on its exemptions:

- CIC and Central Huijin must continue to do a majority of their business outside the United States.
- CIC and Central Huijin must inform the Fed of any acquisition of 25 percent or more of any company that has activities in the United States, as well as any acquisition of 5 percent or more of a company that engages in financial holding activities in the United States.
- ICBC's U.S. branch can do business with other companies controlled by CIC, but transactions with a single controlled company are limited to 10 percent of the branch's lending base, and transactions with all controlled companies cannot exceed 20 percent of the lending base.
- The foreign bank subsidiaries of China's banks cannot engage in any cross-marketing of goods and services with companies controlled by CIC.
- The Fed reserves the right to come up with new requirements for supervising the banks over time; for instance, future investments by CIC can be assessed for conflict of interest.[167]

In addition to the exemption under the BHCA, the Fed was very generous in its interpretation of financial supervision in China. The Fed must demonstrate that any of the banks it approves conform to comprehensive and consolidated supervision criteria. That essentially means that home country regulators are able to monitor and control a bank's overseas activities; are sufficiently informed about its financial condition through both audits and consolidated reports of its worldwide activities; and are aware of all its transactions with its affiliates at home and abroad. The Fed was evidently concerned about China's ability to meet the comprehensive and consolidated supervision criteria, given its heavy state ownership; the poor quality of Chinese banks' loan portfolios; lax risk management; and widespread fraud. However, in granting the approvals, the Fed deemed China to be "actively working to establish" such supervision.[168]

The approval of CIC's share conversion in Morgan Stanley was another important test case for financial regulation of a Chinese SWF. In a positive sense, the Fed asserted its authority to approve such transactions. CIC's initial investment in 2007 did not require BHCA approval, and CIC took special care to keep its share in the firm below 10 percent so as not to be considered an active investor. But in 2010, CIC still had to seek Fed approval when it converted its share in Morgan Stanley into voting shares. The justification, according to the Fed, was that both CIC and Morgan Stanley had been converted into bank holding companies under U.S. law – the Fed required approval for any CIC investment in a U.S. bank holding company above 5 percent.[169]

Although the Fed expanded its approval powers in this case, its decision was again lenient. While it recognized CIC as a "government-owned investment company organized to invest the foreign exchange reserves of the government", it did not find this to have any impact on CIC's financial and managerial resources. The Fed argued that the diverse representation of government agencies on CIC's board, and the "periodic external audits" conducted by China's National Audit Office, were sufficient to show that "appropriate authorities in China would appear to have full access to and oversight of CIC and its activities."[170] The Fed approval document contained no special analysis related to sovereign wealth funds or regulatory concerns regarding a foreign government as a controlling stockholder.[171]

Internal Revenue Service Tax Exemptions

While CIC has demanded to be treated like a private investor by CFIUS and the Fed, its status as a sovereign investor may also be reducing its tax burden under U.S. law. In section 892(a)(1) of the Internal Revenue Code, the income of foreign governments received from stocks, bonds, or other domestic securities is exempt from taxation. The rule was presumably introduced for central banks acting as passive investors in the United States. However, with the advent of aggressive investment by SWFs, the rule has become more controversial.[172]

At present, CIC and other SWFs are still treated as "foreign governments" under U.S. tax law. As such, their investments in stocks, bonds, or other domestic securities are still tax exempt under certain conditions. The exemption has even been expanded to account for the growing commercial activity of SWFs. Under the original law, any "commercial activity income" by an entity controlled by the SWF makes that entity subject to full taxation.[173] In 2008, Senator Max Baucus (D.-MT), then chairman of the Senate Committee on Finance, and Senator Chuck Grassley (R.-IA), then the ranking member, requested that the nonpartisan Joint Committee on Taxation review the tax policy on sovereign investors. They reasoned that "[due to] the rapid increase in the size and number of SWFs, their U.S. investments, and their expected continued growth, it is appropriate to examine the tax regime applicable to their U.S. investments and its policy underpinnings."[174]

In November 2011, the IRS proposed regulations to make it easier for foreign governments to avoid taxation. The new rules mandate that SWFs will no longer be regarded as "commercial entities" simply because they hold interest as a limited partner in a limited partnership. Rather, SWFs can engage in commercial activities and remain tax exempt as long as their commercial activities do not exceed 5 percent of their gross income or their assets in a commercial entity are less than 5 percent of their total assets. Further, investments in financial instruments will not be treated as commercial activities whether or not the instruments are held in the execution of financial or monetary policy. Nor will profits from the sale of a U.S. real property be constituted as commercial activity. [175]

Conclusion

In less than a decade, China's SWFs have become major actors in the global economy. China is only one of many countries that have developed SWFs; yet it is also an outlier. China has the world's largest foreign exchange reserves, several SWFs, and by some counts, one-quarter of global SWF assets. It could be recycling the dollars it has earned from the international economy into the domestic economy, a process that would potentially redistribute wealth and stimulate consumption. But China's monetary and industrial policy remains focused on encouraging exports and keeping factors of production – notably capital – in state hands. That has led to a buildup of foreign exchange reserves and provided incentives for using SWFs.

Even if China's SWFs continue to expand, their strategic orientation remains vague. CIC has only managed a very small portion of China's foreign exchange reserves and has faced competition from other state-sponsored entities. It has yet to establish a stable funding mechanism, and has had trouble finding a successor for former Chairman Lou Jiwei. The fund has made efforts to become more professional, but the presence of officials in the senior management suggests that at least some of the fund's decisions are politicized. Engagement in strategic sectors, coordination with SOEs, and economic diplomacy further suggest that CIC's motives are not strictly commercial.

Concerns about China's SWFs in the U.S. economy could be addressed in several ways:

- *Promote economic reform in China.* The U.S. government, through the Strategic and Economic Dialogue and other mechanisms, could urge China to revalue its currency and reduce its current account surplus. As C. Fred Bergsten of the Peterson Institute has noted in new research, currency manipulation has been one of the major impediments to fixing the global economy.[176] Economic reform will reduce China's buildup of foreign currency reserves and its incentive to expand SWF investments. The net benefits to the United States of China's economic rebalancing will outweigh the value to the United States of China's SWF investment.
- *Urge CIC to clarify its holdings and investment strategy.* CIC's holdings in state-owned commercial banks in China, coupled with its lack of transparency in specifying its shareholder and management relations with the government, violate the spirit of the Santiago Principles and may pose a risk to the global financial sector. Even in China, academics and journalists have expressed concern about the lack of binding rules and laws for the fund.[177] The Fed's conditional exemptions under the Bank Holding Company Act may have set a negative precedent for dealing with this issue.
- *Increase CFIUS oversight.* In 2012, the USCC recommended that Congress consider (1) requiring a mandatory review of all controlling transactions by Chinese state-owned and state-controlled companies investing in the United States; (2) adding a net economic benefit

test to the existing national security test that CFIUS administers; and (3) prohibiting investment in a U.S. industry by a foreign company whose government prohibits foreign investment in that same industry."[178] These recommendations could be relevant for reviewing the investments of CIC and its banking affiliates in the United States.

- *Further develop the Santiago framework.* The GAPP principles encourage transparency among SWFs but are nonbinding and do not cover all SWFs, let alone other state-sponsored entities. The framework could be made more intensive and extensive. It could also foster more dialogue with SWF countries through the SWFI and IFSWF.
- *Regulate hedge funds and other fund managers.* As China's SWFs outsource to and buy equity in fund management companies, the U.S. government should remain informed about the nature of these partnerships in order to preempt a buildup of sovereign wealth in the "shadow banking" system.

Appendix

Table A-1: Varying Definitions of a Sovereign Wealth Fund

• International Monetary Fund	SWFs are government-owned investment funds set up for a variety of macroeconomic purposes.
• International Working Group on Sovereign Wealth Funds (Santiago Principles)	SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives and employ a set of investment strategies that include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.
• Organization for Economic Cooperation and Development	SWFs are pools of assets owned and managed directly or indirectly by governments to achieve national objectives.
• Sovereign Wealth Fund Institute	A SWF is a state-owned investment fund or entity that is commonly established from balance of payments surpluses, official foreign currency operations, the proceeds of privatization, governmental transfer payments, fiscal surpluses, and/or receipts resulting from resource exports. The definition of sovereign wealth fund excludes, among other things, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises in the traditional sense, government-employee pension funds (funded by employee/employer contributions), or assets managed for the benefit of individuals.
• U.S. Department of the Treasury	SWFs are investment vehicles funded by foreign exchange assets and managed separately from official reserves.
• Ashby H.B. Monk, Boston College	SWFs are government-owned and -controlled (directly or indirectly) investment funds that have no outside liabilities or beneficiaries (beyond the government or the citizenry in abstract) and that invest their assets, either in the short or long term, according to the interests and objectives of the sponsoring government.

Table A-2: Comparison of China's Sovereign Wealth Funds

	SAFE Investment Company (Hua'An)	**National Social Security Fund (NSSF)**	**China Investment Corporation (CIC)**	**China-Africa Development Fund (CADF)**
Year Established	1997	2000	2007	2007
Assets ($ billions)	$568	$140	$487	$5 (initial capital)
Official objectives	Diversify foreign exchange reserves in order to reduce risks of fluctuations in value of the U.S. dollar. Do so primarily through acquisition of low-risk assets, like U.S. treasuries.	Strategic reserve fund accumulated by the central government to support future social security expenditures and other social security needs. Aim is to retain and increase the real value of pension funds	Diversify foreign exchange reserves by maximizing returns on risk-adjusted investments.	Promote African economic development through subsidized credit.
Locations	Hong Kong	Beijing	Beijing; Toronto; Hong Kong	Beijing
Legal basis	Registed as a Hong Kong limited company	Established under Article 71 of the *Social Insurance Law of the People's Republic of China*	Incorporated under *China Corporate Law*	Created after approval by the State Council of CDB-sponsored *China-African Development Fund Establishment Plan*
Owner	People's Bank of China (PBOC)	National Council for Social Security Fund	State Council	China Development Bank
Governance	- Run as a branch of the Reserve Management Department of the State Administration of Foreign Exchange (SAFE), under the PBOC. - One of SAFE's four foreign investment arms - Hua'An is based in Hong Kong, the other arms are in London, New York, and Singapore.	- Run as a department of the NCSSF, which is a ministry-level agency	- Independent unit, with some day-to-day affairs overseen, by the Ministry of Finance (MOF) - However, CIC is equivalent in rank to a ministry, reports directly to the State Council, and receives its personnel appointments from the State Council	- Run as a branch of the China Development Bank
Board composition	Managed by a board of directors comprised of top officials from SAFE	- Managed by a board of directors appointed by the State Council -Chairman is usually a retired official from the MOF	Includes government officials from numerous financial sector agencies, including MOF, China Banking Regulatory Commisison, and the central bank	Includes leaders of the CDB, and officials from various ministries (MOF, MOFCOM, and the NDRC)

Table A-3: Global Fund Management Industry

US$ trillions		2003	2005	2007	2009	2011	Compound annual growth rate (%)
Conventional	(Pension, mutual, and insurance funds)	46.9	58.9	76.4	71.3	79.8	7%
Non-conventional	**Sovereign Wealth Funds**	**1.5**	**2.3**	**3.7**	**3.8**	**4.8**	**16%**
	Private equity	1.0	1.2	2.2	2.5	2.2	11%
	Hedge funds	0.9	1.4	2.2	1.7	1.9	11%
	Exchange-Traded Funds	0.2	0.4	0.7	1.0	1.4	30%
	Private wealth	28.5	33.3	40.7	39.0	42.0	5%
	TOTAL	78.8	97.4	125.8	119.3	132.1	7%

Composition (%)		2003	2005	2007	2009	2011	Change 2003-2011
Conventional	(Pension, mutual, and insurance funds)	59.5%	60.5%	60.7%	59.8%	60.4%	0.9%
Non-conventional	**Sovereign Wealth Funds**	**1.9%**	**2.4%**	**3.0%**	**3.2%**	**3.6%**	**1.8%**
	Private equity	1.2%	1.3%	1.7%	2.1%	1.7%	0.4%
	Hedge funds	1.1%	1.4%	1.7%	1.4%	1.4%	0.4%
	Exchange-Traded Funds	0.2%	0.4%	0.6%	0.8%	1.1%	0.8%
	Private wealth	36.1%	34.2%	32.3%	32.7%	31.8%	-4.4%

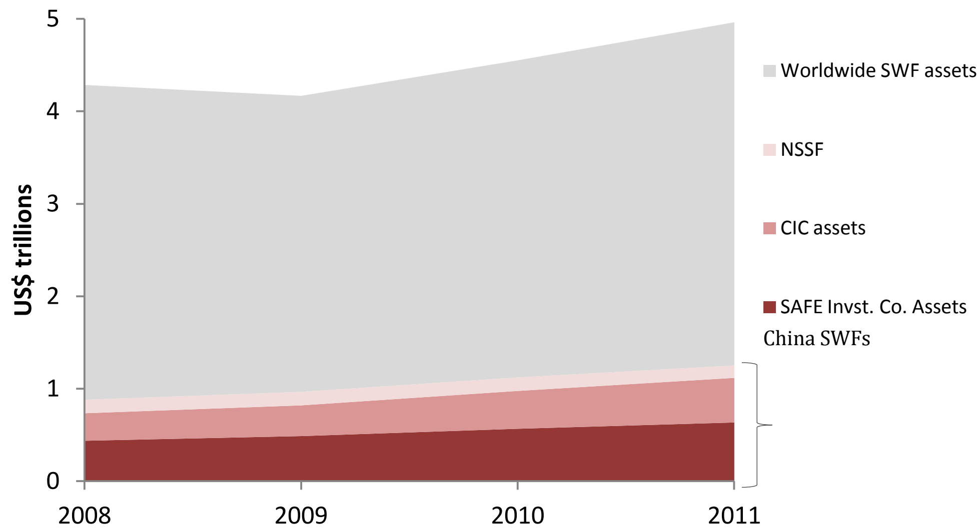
Source: The City-UK estimates. *http://stagingtcuk.positive-technology.com/research/our-work/reports-list/fund-management-2010/*.

Table A-4: Sovereign Wealth Fund Rankings (SWFI Estimates, 2011)

Rank	Country	SWF Name	Assets (US$ billion)	Inception	Origin
1	Norway	Government Pension Fund - Global	664.3	1990	Oil
2	UAE - Abu Dhabi	Abu Dhabi Investment Authority	627.0	1976	Oil
3	**China**	**SAFE Investment Company**	**567.9**	**1997**	**Non-Commodity**
4	Saudi Arabia	SAMA Foreign Holdings	532.8	n/a	Oil
5	**China**	**China Investment Corporation**	**482.0**	**2007**	**Non-Commodity**
6	China-Hong Kong	Hong Kong Monetary Authority Investment Portfolio	298.7	1993	Non-Commodity
7	Kuwait	Kuwait Investment Authority	296.0	1953	Oil
8	Singapore	Government of Singapore Investment Corporation	247.5	1981	Non-Commodity
9	Singapore	Temasek Holdings	157.5	1974	Non-Commodity
10	Russia	National Welfare Fund	149.7	2008	Oil
	…				
11	**China**	**National Social Security Fund**	**134.5**	**2000**	**Non-Commodity**
43	**China**	**China-Africa Development Fund**	**5.0**	**2007**	**Non-Commodity**
		Total Oil & Gas Related	2,991.4		
		Total Other	2,214.5		
		TOTAL	5,205.9		

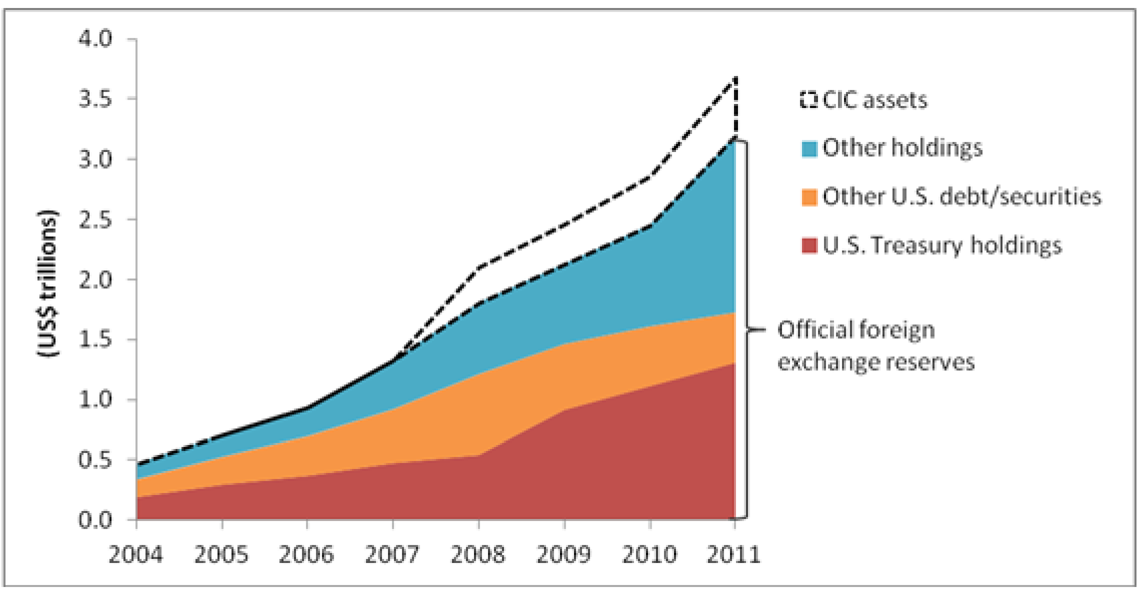
Source: Sovereign Wealth Fund Institute. *http://www.swfinstitute.org/fund-rankings/.*

Figure A-1: Worldwide SWF Assets, 2008-2011



Note*:* National Social Security Fund (NSSF) assets based on original registered capital.
Sources*:* Sovereign Wealth Fund Institute. *http://www.swfinstitute.org/fund-rankings*/; China Investment Corporation, *2008-2011 Annual Reports (Beijing, China)*.

Figure A-2: CIC Assets in Relation to Official Reserves



Sources*:* U. S. Department of the Treasury, PBOC, CIC annual reports.

Table A-5: Holdings of Central Huijin

	Core Business	Company Name	Type of Entity	Percentage (%)		Core Business	Company Name	Type of Entity	Percentage (%)
1	Assets Management	Jiantou Zhongxin Assets Management Co, Ltd.	Limited liability	70.0	10	Investments	China Jianyin Investment Limited	Wholly State-owned	100.0
2	Banking	Bank of China Limited	Joint Stock	67.6	11	Investments	China Everbright Industry Group Limited	Wholly State-owned	100.0
3	Banking	China Construction Bank Corporation	Joint Stock	57.1	12	Investments	China Galaxy Financial Holdings Co., Ltd.	Joint Stock	78.6
4	Banking	China Everbright Bank Co., Ltd.	Joint Stock	48.7	13	Securities	China Investment Securities Co., Ltd	Wholly State-owned	100.0
5	Banking	China Development Bank Corporation	Joint Stock	47.6	14	Securities	China International Capital Co., Ltd.	Limited liability	43.4
6	Banking	Agricultural Bank of China Limited	Joint Stock	40.1	15	Securities	China Securities Co., Ltd.	Joint Stock Company	40.0
7	Banking	Industrial and Commercial Bank of China Limited	Joint Stock	35.4	16	Securities	Shenyin & Wanguo Securities Co., Ltd	Joint Stock	37.2
8	Insurance	China Reinsurance (Group) Corporation	Joint Stock	84.9	17	Securities	Guotai junan Securities Co., Ltd.	Joint Stock	21.3
9	Insurance	New China Life Insurance Co., Ltd.	Joint Stock	31.3	18	Securities	UBS Securities Co., Ltd.	Limited liability	14.0

Source: "investments," Central Huijin Ltd. website, *http://www.huijin-inv.cn/hjen/investments/popup.htm.*

Table A-6: Major CIC Transactions with Outside Fund Managers

Equity Stakes in Fund Managers

Year	Month	Firm Type	Firm	Country	Amount (US$ millions)	Size of share (%)
2007	May	Private equity	Blackstone	USA	$3,030	9.4%
2007	Dec	Investment bank	Morgan Stanley	USA	$5,000	9.9%
2008	Oct	Private equity	Blackstone	USA	$200	3.0%
2009	Jun	Investment bank	Morgan Stanley	USA	$1,210	1.0%
2009	Jun	Private equity	Blackrock	USA	$1,000	3.0%
2009	Jul	Investment bank	CITIC Capital	China (HK)	$250	40.0%
2009	Sep	Investment bank	Poly (Hong Kong) Investments Ltd.	China (HK)	$53	2.8%
2010	Feb	Private equity	Apax Finance	UK	$960	2.3%
2010	May	Commodity fund	Penn West Energy	Canada	$435	5.0%
2010	Dec	Investment bank	BTG Pactual	Brazil	$300	3.1%
2011	Feb	Private equity	VTB Group	Russia	$100	5.0%
2011	Dec	Commodity fund	Shanduka Group	South Africa	$250	25.1%
2011	Dec	Middle-market Germany equities	Deutsche Bank (New Germany Fund Inc.)	USA	n.a.	5.0%
2012	Feb	Commodity fund	EIG Global Energy Partners	USA	n.a.	n.a.

Financing of Fund Vehicles

Year	Month	Fund Type	Firm	Country	Amount (US$ millions)
2008	Apr	Private equity	JC Flowers	USA	$3,200
2008	Sep	Mutual fund	Reserve Primary Fund	USA	$5,400
2009	Mar	Investment banking	Morgan Stanley	USA	$800
2009	Jun	Private equity	Blackstone	USA	$500
2009	Aug	Hedge fund (fixed-income)	Capula Investment Management LLP		$200
2009	Sep	Hedge fund (fixed-income/ distressed)	Oaktree Capital Management	USA	$600
2009	Sep	Real estate fund (distressed)	Goldman Sachs	USA	$600
2010	Feb	Commodity fund	State Street Advisors (SPDR Gold Trust)	USA	$156
2010	Feb	Commodity fund	U.S. Oil Fund	USA	$79
2010	Feb	Private equity	Apax Partners	UK	$1,200
2010	Feb	Private equity	Lexington Partners	USA	$500
2010	Feb	Private equity	Pantheon Venture	USA	$500
2010	Feb	Private equity	Goldman Sachs	USA	$500
2010	Mar	Commodity fund	Brookfield	Canada	$200
2010	May	Commodity fund	Penn West Energy	Canada	$817
2011	Feb	Investment banking	Morgan Stanley	Japan	$190
2011	Oct	Private equity	Russian Direct Investment Fund	Russia	$1,000
2012	Apr	Private equity	Blackrock (to be launched 2013)	USA	$200

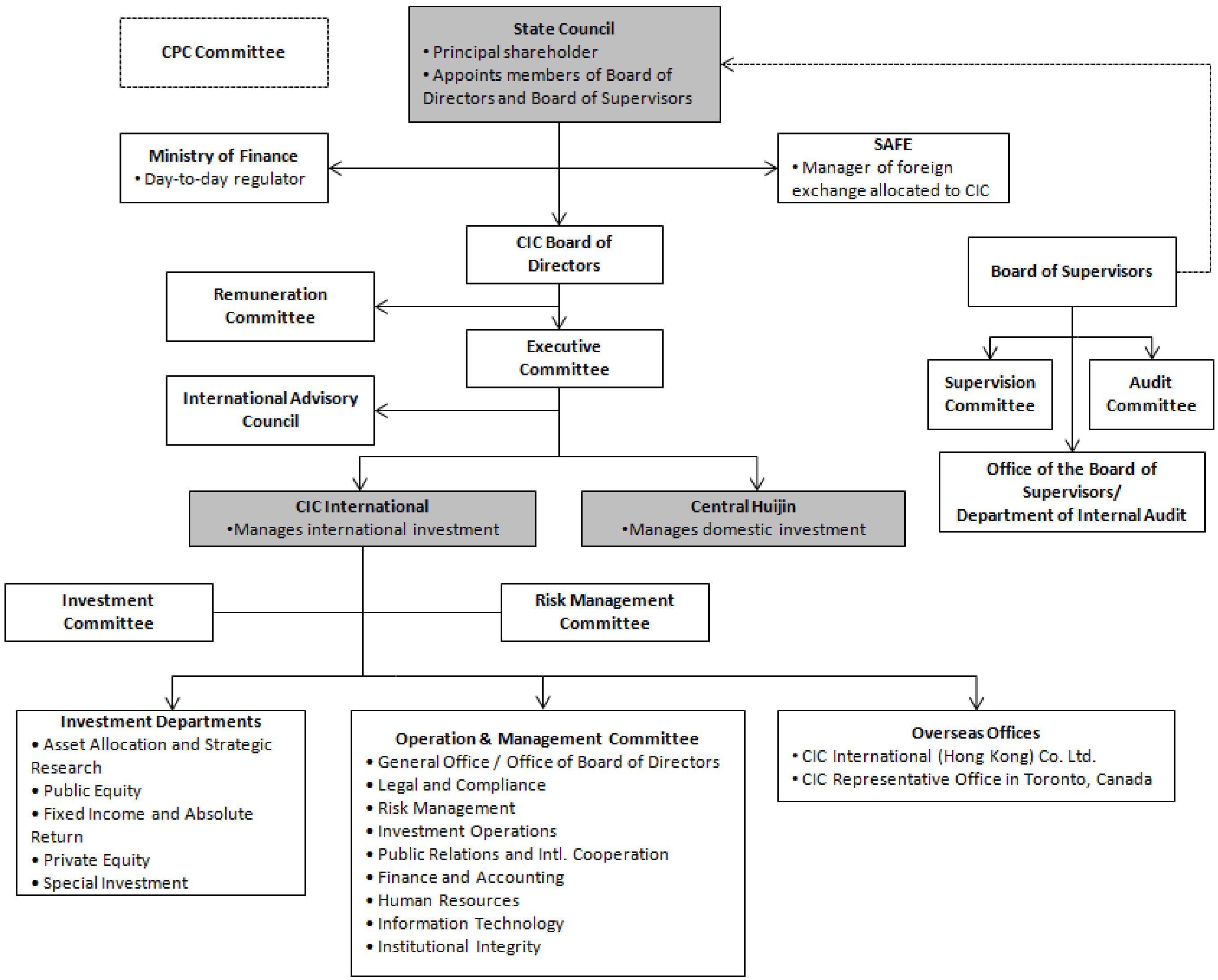
Table A-7: Chronology of Major CIC Investments (Excluding Investment Funds)

Year	Month	Amount (S millions)	Share Size	Partner/Target	Sector	Subsector	Country
2007	**May**	**$3,030**	**9.4%**	**Blackstone**	**Finance**	**Investment**	**USA**
2007	Nov	$100	4.0%	China Railway Group	Transport		China (HK)
2007	**Dec**	**$5,600**	**9.9%**	**Morgan Stanley**	**Finance**	**Investment**	**USA**
2008	**Mar**	**$100**	**0.5%**	**Visa**	**Finance**		**USA**
2008	**Oct**	**$200**	**3.0%**	**Blackstone**	**Finance**	**Investment**	**USA**
2009	**Jun**	**$1,210**	**1.0%**	**Morgan Stanley**	**Finance**	**Banking**	**USA**
2009	**Jun**	**$714**	**-**	**Blackrock**	**Finance**	**Investment**	**USA**
2009	Jul	$1,500	17.2%	Teck Resources	Metals	Copper	Canada
2009	Jul	$250	40.0%	CITIC Capital	Finance	Banking	China (HK)
2009	Jul	$370	1.0%	Diageo	Agriculture		Britain
2009	Aug	$450	19.0%	Songbird Estates	Real estate	Property	Britain
2009	Aug	$1,090	6.9%	Goodman Group	Real estate	Property	Australia
2009	Sep	$940	10.6%	JSC KazMunaiGas E&P	Energy	Oil & gas	Kazakhstan
2009	Sep	$1,900	-	PT Bumi Resources	Energy		Indonesia
2009	Sep	$858	14.9%	Noble Group Limited	Agriculture		Singapore
2009	Oct	$500.00	-	Iron Mining International	Metals		Hong Kong
2009	Oct	$250	13.0%	South Gobi Energy Resource Ltd.	Energy	Coal	Canada
2009	Oct	$270	45.0%	Nobel Oil Group LTD	Energy	Oil	Russian Federation
2009	**Nov**	**$1,580**	**15.0%**	**AES**	**Energy**		**USA**
2009	Nov	$717	20.1%	GCL-Poly Energy Holdings Ltd.	Energy		Hong Kong
2009	Nov	$400	-	Longyuan Power Group	Energy		Hong Kong
2009	Dec	$500	-	CVRD (Vale)	Metals	Steel	Brazil
2010	Mar	$816	15.8%	Changsha Zoomlion	Manufacturing		China (HK)
2010	Jun	$329	-	Peace River Oil Partnership JV	Energy	Oil & gas	Canada
2010	**Jun**	**$200**		**Chesapeake Energy Corp.**	**Energy**	**Oil & gas**	**USA**
2010	**Nov**	**$1,030**	**7.4%**	**General Growth Properties**	**Real estate**	**Property**	**USA**
2010	Dec	$300	3.1%	BTG Pactual	Finance	Investment	Brazil
2011	Feb	$100	5.0%	VTB Group	Finance	Banking	Russian Federation
2011	Apr	$250	11.6%	Semiconductor Manufacturing International Corp.	Manufacturing	Electronics	China (NYSE listed)
2011	Jul	$100	10.5%	Diamond S Shipping	Transport	Shipping	Global
2011	Aug	$3,150	30.0%	GDF Suez	Energy		France
2011	Sep	$93	19.0%	AES-VCM Mong Duong Power Co. Ltd.	Energy	Coal	Vietnam

2011	Oct	$300	13.8%	Horizon Roads (ConnectEast)	Transport		Australia
2011	Nov	$850	10.0%	Atlantic LNG Company	Energy		Trinidad-Tobago
2011	Dec	$800	50.0%	Global Logsistic Properties-CIC JV	Real estate	Property	Japan
2011	Dec	$243	25.1%	Shanduka Group	Finance	Investment	South Africa
2012	Jan	$920	8.7%	Thames Water	Agriculture		Britain
2012	Feb	$150	7.4%	Sunshine Oilsands	Energy		Canada
2012	May	$420	5.0%	Polyus Gold	Metals		Russian Federation
2012	Jun	$490	7.0%	Eutelsat	Technology	Telecom	France
2012	**Aug**	**$500**	**-**	**Cheniere Energy**	**Energy**	**Oil & gas**	**USA**
2012	Oct	$730	10.0%	Heathrow Ltd. (Heathrow Airport)	Transport	Aviation	Britain
2012	Nov	$400	-	Deutsche Bank	Real estate	Property	Britain
2012	Nov	$110	13.0%	Brookfield Asset Management	Agriculture	Timber	Canada
2012	Nov	$460	34.5%	Global Logistic Properties	Real estate	Property	Brazil

Sources: The Heritage Foundation, *China Global Investment Tracker* dataset (Washington, DC: updated January 2013). *http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map*; Eiichi Sekine, “China Investment Corporation: Investment Performance in 2010 and Outlook,” *Nomura Journal of Capital Markets* 3:3 (Winter 2012) 6; Various news sources

Figure A-3: CIC Organizational Structure



Sources: CIC annual reports, various news sources.

Table A-8: CIC Board Members and Their Current and Former Roles

CIC Position	Name	Current or former role outside of CIC
Board of Directors		
Chairman & CEO	TBD	
Vice Chairman & President	Gao Xiqing (高西庆)	Former Vice Chairman, National Council for the Social Security Fund; Vice Chairman of CSRC
Executive Director, Executive VP & CIO	Li Keping (李克平)	Former Vice Chairman, National Council for the Social Security Fund
Independent Directors	Liu Zhongli (刘仲藜)	Former Minister of Finance; Former Chairman, CPPCC Subcommittee of Economy
	Wang Chunzheng (王春正)	Former Head, Leading Group for Financial and Economic Affairs; Vice Minister, NDRC
Non-Executive Directors	Zhang Xiaoqiang (张晓强)	Current Vice Chairman, NDRC
	Li Yong (李勇)	Current Vice Minister of Finance
	Chen Jian (陈健)	Current Vice Minister of Commerce
	Hu Xiaolian (胡晓炼)	Current Deputy Governor, PBOC
	Fang Shangpu (方上浦)	Current Deputy Administer, SAFE
Employee Director	Li Xin (李炘)	Former Deputy Director, Commission for Science, Technology and Industry for National Defense; division chief at the Ministry of Finance
Board of Supervisors		
Chairman of the Board of Supervisors	Li Xiaopeng (李晓鹏)	Former Vice President of ICBC
Supervisors	Dong Dasheng (董大胜)	Current Deputy Auditor General, National Audit Office
	Zhou Mubing (周慕冰)	Current Vice Chairman, China Banking Regulatory Commission
	Zhuang Xinyi (庄心一)	Current Vice Chairman, China Securities Regulatory Commission
Employee Supervisor	Cui Guangqing (崔光庆)	Former Director General, Information and Postal Audit Office, of the National Audit Office
Executive Committee		
Chairman & CEO	TBD	
Vice Chairman & President	Gao Xiqing (高西庆)	Former Vice Chairman, National Council for the Social Security Fund; Vice Chairman of CSRC
Executive Director, Executive VP & CIO	Li Keping (李克平)	Former Vice Chairman, National Council for the Social Security Fund
Chairman of the Board of Supervisors	Li Xiaopeng (李晓鹏)	Former Vice President of ICBC

Executive Vice President	Peng Chun (彭纯)	Former Executive Director and Executive Vice President of the Bank of Communications
Executive Vice President	Fan Yifei (范一飞)	Former Executive Vice President of the China Construction Bank (CCB)
Executive Vice President	Xie Ping (谢平)	Former Chairman of Shenyin & Wanguo Securities Co. Ltd.; Formerly held numerous positions at PBOC
Executive Vice President	Wang Jianxi "Jesse Wang" (汪建熙)	Former Deputy Chairman of China International Capital Corporation; Former Assistant Chairman of CSRC
Executive Vice President & Secretary of Discipline Inspecting Commission	Liang Xiang (梁骧)	Former Secretary of Discipline Inspecting Commission in the Export-Import Bank of China
Chief Strategy Officer	Zhou Yuan (周元)	Former Executive Vice Chairman of Hong Kong Mercantile Exchange
Chief Risk Officer	Guo Xiangjun (郭向军)	Former Deputy Director General of the Department of Fiscal and Financial Affairs of the NDRC; Former Deputy Director General of the Macroeconomic Control Department of the State Council Office for Restructuring the Economic System
Chief Information Technology Officer	Hua Hua (华桦)	Former Vice President of Great Wall Software International Ltd.
Member of the Executive Committee	Zhao Haiying (赵海英)	Former Deputy Director of the Department of Securities Issuance Supervision at CSRC

Sources: China Investment Corporation, *Annual Report 2011* (Beijing, China: 2012); various news sources.

Table A-9: CIC's Adherence to Santiago Principles on Public Disclosure

GAPP	Principle/Subprinciple	Adherence
GAPP 1	GAPP 1.2 Subprinciple: The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.	CIC publicly discloses that its legal basis is in accordance with Company Law of the People's Republic of China. CIC does also disclose its legal relationship with its shareholder, the State Council, and its obligations to the Ministry of Finance and People's Bank of China.
GAPP 2	The policy purpose of the SWF should be clearly defined and publicly disclosed.	CIC publicly discloses its policy purpose in its company profile. As stated in the *2011 Annual Report* overview, "It [CIC] was established as a vehicle to diversify China's foreign exchange holdings and achieve higher long-term returns within acceptable risk tolerance on its investments."
GAPP 4	GAPP 4.1 Subprinciple: The source of SWF funding should be publicly disclosed.	The CIC website states that registration capital was funded from an "issuance of special bonds worth RMB 1.55 trillion by the Ministry of Finance." A subsequent capital injection of $30 billion from SAFE is also noted in the *2011Annual Report*.
	GAPP 4.2 Subprinciple: The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.	CIC does not state its approach to withdrawals. However, given the nature of the fund, withdrawals to supplement the national budget have not occurred.
GAPP 16	The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.	Government framework and objectives are outlined in the "Corporate Governance" section of the *2011 AnnualRreport*.
GAPP 17	Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.	CIC discloses relevant financial information such as asset allocation and the rate of return of its overseas portfolio. However, exact returns from its domestic portfolio, which includes Central Huijin, are undisclosed.
GAPP 18	GAPP 18.3 Subprinciple: A description of the investment policy of the SWF should be publicly disclosed.	CIC does include a description of their investment policy that includes statements regarding its investment themes, objectives, horizon, and asset allocation in its annual report.
GAPP 19	GAPP 19.1 Subprinciple: If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.	CIC's annual report discusses the investment decision process that is conducted under the CIC charter. All decision- making is conducted under the Investment Committee's oversight, which is then reviewed by the Investment Review Committee. CIC states that "CIC has full operational independence and makes its investment decisions based on its assessment of economic and financial objectives."
GAPP 21	SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.	CIC states in its *2011 Annual Report*, "As a financial investor, we usually maintain a minority shareholder status and do not seek to control or influence investee companies. Nor do we always exercise our full ownership rights. When we do, we are consistent with our investment policy to protect the value of our investment. CIC continues to strengthen its postinvestment management process and strives to do what we can as a minority shareholder to help our investee companies achieve success. By helping these companies thrive, we also fulfill our own value creation objectives."
GAPP 22	GAPP 22.2 Subprinciple: The general approach to the SWF's risk management framework should be publicly disclosed.	CIC discloses its risk management framework in its annual report.

Table A-10: CIC Financials, 2008-11

Consolidated Balance Sheets ($ millions)				
Assets	**2008**	**2009**	**2010**	**2011**
Cash and deposits	47,803	18,622	14,480	20,088
Financial assets at fair value through profit or loss				
Cash and deposits	45,436	20,673	3,458	8,058
Equities	1,949	39,828	65,645	59,718
Fixed-income securities	8,312	25,383	34,932	38,644
Alternative investments	362	7,430	29,274	40,470
Total financial assets at fair value through profit or loss	56,059	93,314	133,309	146,890
Receivable and prepayments	1,565	3,067	4,210	5,923
Available-for-sale investments	N/A	N/A	113	119
Held-to-maturity investments	15,189	14,424	2,000	2,000
Long-term equity investments[40]	171,156	201,409	253,340	304,880
Deferred tax assets	1,765	962	1,046	1,742
Other assets	4,003	596	1,081	525
Total Assets	297,540	332,394	409,176	482,167

CIC Liabilities ($ millions)				
	2008	**2009**	**2010**	**2011**
Financial liabilities at fair value through profit or loss	5,346	4,057	2,637	494
Bonds payable	N/A	N/A	16,609	17,461
Deferred tax liabilities	43	1,575	3,772	1,505
Other liabilities	3,395	6,752	12,259	37,615
Total liabilities	8,784	12,384	35,277	57,072
Owner's Equity				
Owner's Capital	200,000	200,000	200,000	200,000
Capital reserves and others	88,756	120,010	174,302	225,095
Total owner's equity	288,756	320,010	374,302	425,095
Total liabilities and owner's equity	297,540	332,394	409,579	482,167

Consolidated Income Statements ($ millions)				
Investment income	**2008**	**2009**	**2010**	**2011**
Interest income	4,066	1,656	2,052	2,293
Dividend income	135	983	1,109	1,525
Realized gains on investments	50	186	1,838	2,621
Unrealized gains (losses) from changes in fair value of investments	-6,495	10,318	9,784	-11,350
Investment income from long-term equity investments	26,367	31,706	40,761	53,383
Foreign exchange gains (losses)	-167	72	-175	70
Other income	N/A	N/A	24	47
Total investment income	23,956	44,876	55,393	48,589
Expense				
Investment expense	-42	-106	-311	-385
General and administrative expense	-32	-47	-79	-135
Finance expense	N/A	N/A	-213	-660
Impairment loss	-21	N/A	12	N/A
Total expense	-95	-153	-591	-1,180
Income				
Operating income	23,861	44,723	54,802	47,409
Others, net	1	-25	-1	-2
Income before taxes	23,862	44,698	54,801	47,407
Income taxes	-731	-3,038	-3,241	1,015
Net income	23,131	41,660	51,560	48,422

Source: China Investment Corporation, *2008-2011 Annual Reports* (Beijing, China).

[40] Principally investments by Central Huijin

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