China's Sovereign Wealth Fund: Developments and Policy Implications

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Summary

China's ruling executive body, the State Council, established the China Investment Corporation (CIC), a sovereign wealth fund, in September 2007 to invest $200 billion of China's then $1.4 trillion in foreign exchange reserves. As with other sovereign wealth funds worldwide, the CIC's existence allows China to invest its reserves in a wide range of assets, including stocks, bonds, and hedge funds. After a rocky start in which it incurred losses of 2.1% on its global investments in 2008 – caused in part by aftereffects of the global financial crisis of 2007 – the CIC's rate of return in 2009 rose to 11.7%. The State Council is reportedly considering a CIC request for an additional $200 billion out of China's $2.5 trillion in foreign exchange reserves.

Congress and financial analysts raised concerns about the CIC after its creation, partly because it was a comparatively large sovereign wealth fund, partly because it was government-owned, and partly because it reported directly to the State Council. Some observers were apprehensive that the Chinese government would use the CIC to acquire control over strategically important natural resources, obtain access to sensitive technology, and/or disrupt international financial markets. The CIC attempted to counter these concerns by announcing that its investment strategy would conform to international standards, and sought only to maximize its "risk-adjusted financial return." The CIC also promised to avoid politically and strategically sensitive investments.

The CIC has been the focus of discussions among China's leadership about its economic objectives and its organizational structure. Soon after its creation, the CIC became the sole owner of Central Huijin Investment Limited (Central Huijin), an investment fund established by China's central bank, the People's Bank of China (PBOC), as a vehicle for injecting capital into major Chinese banks. Over the last three years, Central Huijin has provided billions of dollars to the Bank of China (BOC), the China Construction Bank (CCB), the Industrial and Commercial Bank of China (ICBC), and other financial institutions. Some analysts maintain that there is an inherent conflict between the CIC's goal to maximize its return on investments and Central Huijin's mission to provide capital to domestic financial institutions, and advocate their separation. While there have been reports of a possible separation, Central Huijin remains a subsidiary of the CIC.

Concerns about the CIC's investment activities reemerged in 2009 when it greatly expanded its overseas holdings, and began acquiring stakes in energy companies, natural resource companies and alternative energy companies. According to its filings with the Security and Exchange Commission (SEC), the CIC had holdings in 82 U.S. entities as of December 31, 2009. Commentators once again questioned the true goals of the CIC's investment strategy. The CIC maintains that its main mission is to maximize its long-term, risk-adjusted rate of return.

For Congress, the investment activities of the CIC and its subsidiary, Central Huijin, raise questions about U.S. policies on inward foreign direct investment (FDI) and the global competitiveness of U.S. financial institutions. Some question if the current controls on inward FDI via the Committee on Foreign Investment in the United States, SEC, and other agencies provide adequate protection of U.S. strategic assets and technology from investments by the CIC and other Chinese entities. Others are concerned that Central Huijin's assistance to Chinese banks and financial institutions are part of a larger strategy to increase China's influence in strategic markets. These commentators suggest that more should be done to protect the United States from China's rising role in international capital markets.

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Introduction

The Chinese government decided in 2007 to join a growing list of nations and create a sovereign wealth fund (SWF).[1] The resulting entity—the China Investment Corporation (CIC)—with an initial capital fund of $200 billion, was a significant new addition to the existing pool of SWFs (see **Table 1**). The rapid expansion of SWFs in 2007, and in particular, the CIC's creation, became the subject of significant congressional inquiry in 2007 and 2008.[2] Several congressional committees – including the Joint Economic Committee, the Senate Banking Committee, the Senate Foreign Relations Committee, the House Financial Services Committee, and the House Foreign Relations Committee – held hearings on the growth of SWFs and their implications for the U.S. economy and national security. In February 2008, the U.S.-China Economic and Security Review Commission, a congressional advisory panel, convened a day-long hearing on SWFs, with a focus on the CIC.[3]

Table 1. Leading Sovereign Wealth Funds (as of April 2008)

Country	Fund	Size ($ Billion)	Year Created
United Arab Emirates	Abu Dhabi Investment Authority (ADIA)	500 - 875	1976
Norway	Government Pension Fund - Global	375	1990
Singapore	Government of Singapore Investment Corporation (GIC)	200 - 330	1981
Saudi Arabia	Saudi Arabian Monetary Agency	270	1952
Kuwait	Kuwait Investment Authority	213	1953
China	China Investment Corporation, Ltd. (CIC)	200	2007
Hong Kong	Exchange Fund Investment Portfolio	139	1993
Russia	Reserve Fund	128	2008
Singapore	Temasek Holdings	110	1974

Source: CRS summary of table in Edwin Truman, "A Blueprint for Sovereign Wealth Fund Best Practices," *Peterson Institute for International Economics*, No. PB08-3, April 2008.

After the onset of the global financial crisis, concerns about SWFs in general and the CIC in particular diminished, in part because the CIC and many of the other major SWFs sharply curtailed their investment activities. However, starting in 2009, the CIC began making major investments in several different companies, with an apparent focus on energy and natural resources companies. In addition, one of the CIC's subsidiaries, the Central Huijin Investment Corporation (Central Huijin), made substantial investments in several larger Chinese banks and

[1] According to the U.S. Department of the Treasury, a sovereign wealth fund is a "government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities." (U.S. Department of the Treasury, *Semiannual Report on International Economic and Exchange Rate Policies*, June 2007.)

[2] For more about congressional interest in SWFs, see CRS Report RL34336, *Sovereign Wealth Funds: Background and Policy Issues for Congress*, by Martin A. Weiss.

[3] U.S.-China Economic and Security Review Commission, *Hearing on the Implications of Sovereign Wealth Fund Investments for National Security*, 110th Cong., 2nd sess., February 7, 2008.

financial enterprises, which in turn, began to back outward foreign direct investment (FDI) and domestic investments by state-owned enterprises and private corporations.

Its renewed investment activities have rekindled congressional and scholarly concerns about the nature and intent of the CIC's overall investment strategy. Although the CIC maintains that it is an institutional investor seeking to maximize its rate of return, some observers speculate that the CIC is operating as a vehicle for a Chinese government strategy to secure access and possibly control over resources necessary for China's growing economy. Some are concerned that China's expanding international holdings of energy and strategic resources may pose a risk to U.S. security. Discussions of ways to monitor and regulate the investment activities of SWFs and the CIC have reappeared among international experts and in Congress.

Background

China announced in March 2007 that it would create a sovereign wealth fund to invest its accumulated foreign exchange reserves more profitably than the usual low-risk/low-return items, such as U.S. Treasury Notes. After a few delays, China's new sovereign wealth fund officially started operations on September 29, 2007. The CIC provided China with another avenue by which it could invest its growing foreign exchange reserves, which totaled $1.4 trillion as of September 2007, and which have continued to grow, standing at $2.45 trillion as of July 2010.[4]

The genesis of the CIC was apparently subject to political infighting among China's major financial institutions, with both China's central bank, the People's Bank of China (PBOC), and the Ministry of Finance vying for control over the new SWF. In the end, the CIC was placed directly under the control of the State Council, China's ruling executive body. The investment activities of the CIC are nominally directed by an 11-member board of directors. However, a separate seven-person Executive Committee is generally considered to be in charge of the CIC's day-to-day operation.

According to the CIC's webpage, its mission "is to make long-term investments that maximize risk adjusted financial returns for the benefit of its shareholder [the State Council]."[5] From its inception, the CIC has stressed that its investment decisions are made purely on a commercial basis. However, some of its investments raise questions about their commercial merit.[6]

In particular, the CIC assumed responsibility for the assets and liabilities of the Central Huijin Investment Limited (Central Huijin) in November 2007. As a result, the CIC indirectly became a major stock holder in the China Construction Bank (CCB), the Industrial and Commercial Bank of China (ICBC), and other Chinese financial institutions.[7] Central Huijin's main mission is to "make equity investments in major state-owned financial enterprises … to achieve the goal of

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[4] According to China's State Administration of Foreign Exchange (SAFE), its foreign exchange reserves as of the end of September 2007 totaled $1.434 trillion. Monthly data are provided on SAFE's webpage, http://www.safe.gov.cn.

[5] See http://www.china-inv.cn/cicen/about_cic/aboutcic_overview.html.

[6] For more about the initial concerns about CIC's investment goals, see CRS Report RL34337, *China's Sovereign Wealth Fund*, by Michael F. Martin.

[7] According to CCB's webpage http://www.ccb.com, the CHIC owns 70.69% of CCB's shares, including 9.21% owned by its subsidiary, Central Jianyin Investment Company. According to the ICBC's webpage http://www.icbc.com.cn, the CHIC owns 35.33% of ICBC's shares.

preserving and enhancing the value of state-owned financial assets."[8] Some observers see a contradiction between the missions of the CIC and Central Huijin.

Overview of the CIC

The China Investment Corporation is a wholly state-owned company, under the direct supervision of the State Council, China's ruling executive body. The daily operations of the CIC are managed by its Executive Committee, which is overseen by a board of directors (appointed by the State Council) and monitored by a board of supervisors (also appointed by the State Council). the CIC's chief executive officer is Lou Jiwei, its chief operating officer is Zhang Hongli, and its chief risk officer is Jesse Wang Jianxi.[9]

The details of the CIC's investment operations are not readily available and the company's annual reports do not include detailed listings of its holdings. The CIC utilizes both its internal staff of about 250 people, as well as contracted asset management companies and an unknown number of subsidiary investment companies, to make investments. Since its creation, there have been several unconfirmed reports that the CIC has hired specific asset management companies (including U.S. firms) to manage a portion of its investment portfolio, but the CIC and the alleged companies have generally refused to comment on the details. The CIC's 2009 annual report indicates that 51% of its holdings are externally managed and 41% are internally managed.[10] Among the CIC's known subsidiaries are Beijing Wonderful Investment, Ltd., Chengdong Investment Corporation, Country Forest Limited, Fullbloom Investment Corporation, Land Breeze II, Stable Investment Corporation, and Central Huijin. While the CIC technically owns Central Huijin, Central Huijin has its own board of directors, board of supervisors, and executive officers. The CIC's CEO Lou Jiwei is the chairman of Central Huijin's board of directors, and the CIC executive vice president Peng Chun is Central Huijin's chairman.

According to its 2009 annual report, the CIC's investment objective is "to achieve an appropriate long-term and risk-adjusted return for its shareholder [the State Council]."[11] In its efforts to achieve this goal, the CIC says it abides by four key investment principles. First, it selects investments based on commercial criteria. Second, it is a passive, financial investor, and does not seek control of companies. Third, the CIC complies with the laws and regulations of the countries in which it makes investments. Fourth, investments are selected based on research utilizing standard evaluation techniques. In addition, the CIC is a founding member of the International Forum of Sovereign Wealth Funds (IFSWF) and has agreed to abide by the IFSWF's Santiago Principles, which set voluntary guidelines of behavior for SWFs.[12]

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[8] See Central Huijin's webpage, http://www.huijin-inv.cn/hjen/aboutus/aboutus_2008.html?var1=About.

[9] For this report, Chinese names are listed in their traditional order, with surnames first, followed given names. In cases where a person has adopted a Western given name, the adopted name is listed first, followed by the surname, and then the Chinese given names.

[10] China Investment Corporation, *Annual Report 2009*, Beijing, China, July 2010, page 34.

[11] China Investment Corporation, *Annual Report 2009*, Beijing, China, July 2010, page 28.

[12] The Santiago Principles consist of 23 principles concerning the operation and management of sovereign wealth funds, adopted in October 2008 in Santiago, Chile. For the complete text of the principles, see http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf.

Since its creation in September 2007, the CIC has grown from its initial capital endowment of $200 billion to a total worth of $332 billion at the end of 2009. In 2009, the CIC's return on its total registered capital was 12.9% and its return on its global portfolio was 11.7%.[13] In 2008, the return on capital was 6.8% and its global investments lost 2.1%. By comparison, Norway's Government Pension Fund's return on capital in 2009 was 25.6% and in 2008 was -23.3%.[14] Based on its 2009 performance, the CIC has reportedly asked for an additional $200 billion in capital.[15] The State Council has not made a decision on the request.

The CIC's Investment Activities

Because of the separation of management between the CIC and Central Huijin, the investment activities of each entity should be examined independently. In general, the CIC's major investments have been made overseas, while Central Huijin has focused on domestic investments. In addition, Central Huijin's primary objective is to support China's financial institutions; the CIC is supposed to make commercially based investments.

Investments by the CIC

The CIC's investment activities can be divided into three distinct periods (see **Table 2** below). First, just prior to and immediately after its establishment, the CIC focused its investments on financial institutions. The second period was one of comparative investment inactivity in response to the global financial crisis. Third, the CIC reactivated its investment activity starting in 2009, with a notable shift to investments in energy and natural resource companies. The apparent change has raised concerns about the commercial basis of CIC's investment strategy.

According to a report submitted to the Securities and Exchange Commission (SEC) in February 2010, the CIC had holdings in 82 different U.S. entities as of December 31, 2009, with a total worth of $9.627 billion.[16] In addition to those U.S. companies listed in **Table 2**, the CIC held shares in several other major corporations, including Apple, Bank of America, Burlington Northern Santa Fe, Chesapeake Energy, Citigroup, Coca Cola, Eli Lilly, Hartford Financial Services, Ingersoll-Rand, Johnson & Johnson, Merck, Metlife, Motorola, News Corp, Pfizer, Sprint Nextel, Terex, and Wells Fargo.

There have also been a number of unsubstantiated reports of the CIC interest in investing in other companies. In the spring and summer of 2009, there were repeated claims that the CIC was considering providing Australian mining giant Fortescue a loan of $1 billion.[17] The CIC was also reputedly pondering an investment in the French nuclear power company Areva during the summer of 2009.[18] In October 2009, there were claims that CIC was among a list of possible

[13] CIC's registered capital is $200 billion, the initial amount provided at its creation. As of December 31, 2009, CIC's global portfolio was worth $81.1 billion.

[14] As reported in its 2009 annual report, available online at http://www.nbim.no/en/press-and-publications/Reports/2009/annual-report-2009/

[15] "CIC Planning More Resource Investments," *China Daily*, January 28, 2010.

[16] Security and Exchange Commission Form 13F, submitted on February 5, 2010, SEC File Number 028-13664. A complete list of CIC's holdings of U.S. companies is provided in an **Appendix** to this report.

[17] "CIC, Fortescue Metals in Talks for $1b Bond Issue," *China Daily*, August 12, 2009.

[18] "CIC May Buy into France's Areva: Report," *China Knowledge*, September 4, 2009.

investors in Russian aluminum producer United Co Rusal.[19] During a January 2010 forum in Hong Kong, CIC Chairman Lou indicated that the CIC had been discussing possible investments in the mining industries of Brazil and Mexico.[20] More recently, the CIC was reportedly negotiating with Harvard University to purchase some of its real estate funds, but the talks apparently were unsuccessful.[21]

Table 2. Major Investments by the CIC

(in chronological order)

Company (Country)	Type of Industry or Sector	Date of Initial Investment	Type of Investment	Value of Investment	Percentage of Ownership
Blackstone Group (USA)	Financial Services	May 2007[a]	Shares	$3.0 billion	9.4%
Morgan Stanley (USA)	Financial Services	December 2007	Shares	$5.6 billion	9.9%
Visa (USA)	Financial Services	March 2008[b]	Shares	$100 million	0.5%
Reserve Primary Fund (USA)	Investment Fund	September 2008	Fund	$5.4 billion	Not applicable
Morgan Stanley (USA)	Financial Services	June 2009	Shares	$2.2 billion	9.9%[c]
CITIC Capital (China)	Financial Services	July 2009	Shares	$250 million	40.0%
Teck Resources Limited (Canada)	Energy	July 2009	Shares	$1.5 billion	17.5%
JSC KazMunaiGas Exploration Production (Kazakhstan)	Energy	July 2009	Global depository receipts	$940 million	10.6%
Goodman Group (Australia)	Property Development	August 2009	Loan	$159 million	Not applicable
Songbird Estates Limited (UK)	Property Development	September 2009	Shares	$158 million	14.7%
Nobel Oil Group (Russia)	Energy	September 2009	Equity acquisition	$270 million	45.0%
PT Bumi Resources (Indonesia)	Energy/Natural Resources	September 2009	Loan	$1.9 billion	Not applicable
Noble Group Limited (Singapore)	Natural Resources	September 2009	Shares	$858 million	14.9%
Iron Mining International (Hong Kong)	Natural Resources	October 2009	Loan	$500 million	Not applicable
AES Corporation (USA)	Energy	November 2009	Shares	$1.6 billion	15.0%

[19] "Rusal Wants CIC, Temasek as IPO Investors," *China Daily*, October 28, 2009.

[20] "CIC Planning More Resources Investments," *China Daily*, January 28, 2010.

[21] Lingling Wei and Dinny McMahon, "CIC Seeks Harvard's U.S. Real-Estate Portfolio ," *Wall Street Journal*, August 4, 2010; Zoe Hughes, "Harvard, CIC Reportedly End Real Estate Fund Sale Talks," *PERE News*, September 10, 2010.

Company (Country)	Type of Industry or Sector	Date of Initial Investment	Type of Investment	Value of Investment	Percentage of Ownership
SouthGobi Energy Resources Limited (Canada)	Energy	November 2009	Convertible debenture	$500 million	Not applicable
GCL-Poly Energy Holdings Limited (Hong Kong)	Energy	November 2009	Shares	$717 million	20.1%
BlackRock Inc.	Investment Fund	Unknown	Shares	$714 million	unknown
Apax Partners (UK)	Investment Fund	February 2010	Equity acquisition	$956 million	2.3%
Changsha Zoomlion Heavy Industry Science & Technology Development (China)	Manufacturing	March 2010	Shares	$816 million	15.8%
Penn West Energy Trust (Canada)	Energy	May 2010	Equity acquisition	$801 million	45.0%[d]

Source: The CIC annual reports, SEC filings, and various news accounts.

Notes: Precise dates for some transactions are not possible due to the CIC's reluctance to reveal specifics of its investments.

a. Investment made prior to the establishment of the CIC; title to shares transferred to the CIC In November 2007; in October 2008, the CIC negotiated an option to purchase up to 12.5% of Blackstone, which it has not yet fully utilized.

b. As of December 31, 2009, the CIC owned 4.05 million shares of Visa, worth $354 million.

c. The CIC's prior holdings of Morgan Stanley were diluted to 7.7% in October 2008 by an investment by Mitsubishi UFJ Financial Group, Inc. The CIC's June 2009 investment returned its holdings to 9.9% of Morgan Stanley. In July and August 2010, the CIC sold some of its holding in Morgan Stanley to keep its percentage of ownership below 10.0%.

d. A SEC filing of June 1, 2010 reported the CIC's purchase of 5.3% of Penn West Energy Trust's outstanding trust units.

The shift in the CIC's portfolio is also discernible by comparing its reported global portfolio holdings as of the end of 2008 and 2009 (see **Table 3** below). Between the end of 2008 and the end of 2009, the CIC shifted most of its holdings from cash funds into equities and fixed income securities. According to the CIC, this shift was facilitated by several factors. First, the CIC acquired the personnel and capabilities to more efficiently allocate its investments. Second, as global markets began to recover from the financial crisis, new investment opportunities emerged. Third, the perceived "protectionist" attitudes of Europe and the United States to sovereign wealth fund investments diminished, making it easier for the CIC to act on the emerging opportunities.[22]

[22] "CIC's Head Thanks Western Protectionism for Preventing Investment Losses," *China Stakes*, April 20, 2009.

Table 3. the CIC's Global Portfolio Holdings by Type of Investment

As of end of calendar year

Type of Investment	2008	2009
Equities	3.2%	36%
Fixed Income Securities	9.0%	26%
Cash Funds	87.4%	32%
Other Types of Investments	0.4%	6%

Source: China Investment Corporation, *Annual Report 2008 and Annual Report 2009*, Beijing, China.

Investments by Central Huijin

Although Central Huijin is a wholly owned subsidiary of the CIC, according to its website, "the investment business of [the] CIC and the share management function conducted on behalf of the State Council by Central Huijin are completely separated."[23] The CIC's website reinforces the claimed administrative separation between the CIC and Central Huijin:

> Central Huijin Investment Ltd. (Central Huijin) is a wholly-owned subsidiary of [the] CIC with its own Board of Directors and Board of Supervisors. It was established to invest in key state-owned financial institutions in China; it does not conduct any other commercial activities and generally is not involved in day-to-day issues within the institutions in which it invests. However, in early 2009, the Central Huijin [sic] took on the task of restructuring ailing financial institutions at the request government regulatory agencies.[24]

Central Huijin's existing portfolio as of December 31, 2009, consisted of banks, security companies, and other financial institutions (see **Table 4**). Since the start of the year, Central Huijin has reportedly acquired holdings in other Chinese financial institutions and is making preparations for more investments. Central Huijin reportedly received title to 43.5% of China Investment Capital Corporation in August 2010.[25] On August 25, 2010, it sold 54 billion yuan ($7.9 billion) worth of bonds, reportedly to finance investments in the Export-Import Bank of China and China Export and Credit Insurance Corporation (Sinosure).[26] On September 18, 2010, Central Huijin sold an additional 55 billion yuan ($8.1 billion) in bonds.[27] Central Huijin supposedly has received approval to issue up to 187.5 billion yuan ($27.6 billion) in bonds to invest in several state-owned banks, including BOC, CCB, and ICBC.[28] These investments are to prevent the dilution of Central Huijin's holdings in the banks after they issue new shares in the future and provide the banks with additional capital.

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[23] http://www.huijin-inv.cn/hjen/aboutus/aboutus_2008.html?var1=About

[24] http://www.china-inv.cn/cicen/about_cic/aboutcic_overview.html

[25] Greg Bright, "CIC Expands Portfolio with Major Investment Bank Stake," *Top 1000 Funds*, August 25, 2010. Morgan Stanley is currently a major shareholder of CICC, but is attempting to sell its holdings, reportedly to Kohlberg Kravis Roberts & Co. and TPG Capital.

[26] "Huijin to Inject 88b Yuan in Exim Bank, Sinosure," *China Daily*, August 10, 2010; Zhang Yuzhe, "Central Huijin Raises 54 Billion Yuan in Bond Sale," *Caixin*, August 26, 2010.

[27] "Central Huijin Raises RMB55 Bln via Two-batch Bonds Sale," *China Daily*, September 19, 2010.

[28] "Huijin to Sell $27.6b of Bonds in First Ever Debt Sale," *China Daily*, August 19, 2010; "Huijin Nodded for 54b Yuan Sale of Bonds," *China Daily*, August 17, 2010.

Table 4. Central Huijin's Investments

(as of December 31, 2009)

Company Name	Date of Investment	Percentage Ownership
Agricultural Bank of China (ABC)	10/29/2008	50.00%
Bank of China (BOC)	12/30/2003	67.53%
China Construction Bank (CCB)	12/30/2003	57.10%
China Development Bank (CDB)	12/31/2007	48.70%
China Everbright Bank	11/30/2007	70.88%
China Galaxy Financial Holdings	7/14/2005	78.57%
China Jianyin Investment	9/9/2004	100.00%
China Reinsurance (Group) Corporation	4/11/2007	85.50%
Guotai Junan Securities	10/14/2005	21.28%
Industrial and Commercial Bank of China (ICBC)	4/22/2005	35.41%
New Life Insurance Co.., Ltd.	11/19/2009	38.82%
Shenyin & Wanguo Securities Co., Ltd.	9/21/2005	37.23%

Source: The Central Huijin's website – http://www.huijin-inv.cn/.

Note: In July 2009, 20.7 billion shares of CCB were transferred from China Jianyin Investment to Central Huijin, raising its holdings to 133.3 billion shares, or 57.10%.

China's Debate over the Role of the CIC

Starting in the summer of 2008, the CIC's poor overseas investment performance, plus internal and external administrative tensions, gave rise to discussions about reforming the CIC. Internally, there were problems reconciling the CIC's overall investment mission with Central Huijin's domestic investment focus. Externally, the State Administration of Foreign Exchange (SAFE), which reports directly to the People's Bank of China (PBOC), made an apparent bid in 2008 to challenge the CIC's role as the Chinese government's leading overseas investment fund.[29]

Stories about possible competition between the CIC and SAFE also surfaced early in 2008. In April 2008, *Caijing Magazine* reported that the State Council had authorized SAFE to invest up to 5% of China's foreign exchange reserves—at the time, the equivalent of nearly $90 billion—in non-fixed income investments.[30] Financial analyst Logan Wright wrote in June 2008 that SAFE's "encroaching on the CIC's turf is likely more reflective of these bureaucratic conflicts than a coordinated government strategy for investing China's foreign exchange reserves."[31]

In July 2008, sources in China reported that Chinese officials were discussing the possible separation of the CIC and Central Huijin.[32] Two of the key issues motivating the possible

[29] For more details of SAFE's challenge to CIC, see CRS Report RL34337, *China's Sovereign Wealth Fund*, by Michael F. Martin.

[30] Yu Ning, "SAFE's Reserve Investments Accelerate," *Caijing Magazine*, April 28, 2008, in Chinese.

[31] Logan Wright, "CIC and SAFE: Coordination or Bureaucratic Conflict?," *China Stakes*, June 24, 2008.

[32] "A Simmering CIC-Huijin Separation," *China Stakes*, July 8, 2008.

separation were the desire to avoid potential regulatory problems and a clarification of the roles of Central Huijin and the CIC. The Federal Reserve licenses for CCB and ICBC branches in New York City were reportedly delayed in part because of the combined shareholdings of the CIC and Central Huijin in the two banks.[33] In August 2008, the U.S. Federal Reserve informed the CIC that it could not subsidize loans for its companies via an ICBC branch in New York City.[34] If the two investment agencies were separated, it was expected that the CIC would remain primarily an investor in overseas assets, while Central Huijin would become an administrator of state-owned financial assets—such as the Agricultural Bank of China, the Bank of China, the China Construction Bank, the China Development Bank, and the Industrial and Commercial Bank of China.

For a time, it appeared that China's leadership had decided not to make major changes in the CIC's organization and operation. On October 22, 2008, China's State Council announced that it was assigning new roles to Central Huijin and China Jianyin Investment Company, but keeping both firms under the CIC.[35] Central Huijin was to serve as a investment institution holding majority stakes in China's larger state-owned banks. As a result, China Jianyin Investment Company would transfer some of its holdings over to Central Huijin, so it could focus on its new function as an "investment platform for companies."[36] In January 2009, it was reported that Central Huijin had taken control of China Jianyin Investment Company's holdings in five securities firms (including CIC Securities and UBS Securities), but not China Investment Capital Corporation (CICC).[37]

Talk of splitting the CIC and Central Huijin reemerged in the summer of 2010.[38] According to news accounts, Chinese authorities were considering divesting the CIC of all of its domestic holdings, including Central Huijin.[39] The split was being contemplated to allow the CIC to diversify its portfolio and focus on its international investments. The move also may be under consideration to free the CIC of various restrictions on its overseas investments, particularly in the United States. According to sources cited in the report, it was unclear if the CIC would be compensated for the approximately $70 billion in domestic holdings. In addition, there was discussion about whether Central Huijin would report directly to the State Council or be acquired by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).

Concerns About the CIC

The recent investment activities of the CIC and its subsidiary, Central Huijin, have raised concerns among some financial analysts.[40] These concerns can be generally divided into two main

[33] Ibid.

[34] Scott Lanman, "Fed Sets Limits on ICBC Loans to China Fund-Owned Companies," *Bloomberg*, September 4, 2008.

[35] Li Qing, "Reshuffling Begins for State Finance Arms," *Caijing Magazine*, November 4, 2008.

[36] Ibid.

[37] Li Qing, "New Roadmap for Central Huijin's Brokers," *Caijing Magazine*, January 6, 2009.

[38] For example, *China Daily* published an article, "CIC Restructuring Plan Under Discussion," on September 10, 2010, discussing alternative proposals for CIC's reorganization.

[39] Li Xiang and Mao Lijun, "Sovereign Fund Spin-off 'Considered'," *China Daily*, July 7, 2010.

[40] For example, see Gordon L. Clark and Ashby H. B. Monk, "Nation-state Legitimacy, Trade, and the China Investment Corporation," March 31, 2010, available at http://ssrn.com/abstract=1582647. The authors are co-directors (continued...)

issues. The first issue is whether the CIC's investments are being made on commercial merit, or are being made for strategic reasons as part of a larger government policy. The second issue is the CIC's commitment to "passive" investment.

The shift in the CIC's direct investments that began in the summer of 2009 from financial entities to energy and natural resources companies caught the attention of investors and analysts alike. Some speculated that the shift indicated a change in the CIC's investment strategy and could be part of a larger Chinese government effort to secure access to natural resources for China's rapidly expanding economy. This speculation was partially fueled by statements from the CIC's officials, who indicated that these investments were hedges against inflation, implying that the investments were made for macroeconomic reasons.

The investment activities of Central Huijin also have been questioned. Although Central Huijin has not made direct investments in non-financial entities, it has been speculated that by providing additional capital to major Chinese banks, Central Huijin is indirectly financing state-owned enterprises and large private companies and their overseas acquisitions and investments. For example, Central Huijin is a major shareholder of CDB, which reportedly provided financing for Chinalco's bid to take over the Australian mining company, Rio Tinto.

The other main issue is the CIC's possible shift from being a passive to an active investor. According to a CIC representative, the sovereign wealth fund voluntarily refused seats on the boards of directors of Blackstone and Morgan Stanley in 2007.[41] However, the CIC has retained the option to appoint someone to the boards for some of its more recent investments, such as AES, GCL-Poly Energy Holdings Limited, and SouthGobi Energy Resources Limited. There are also reports that the CIC promised the SEC that it would not seek more than one seat on Morgan Stanley's board in order to obtain SEC approval for its purchase of more than 10% of the investment company.[42]

Congressional Considerations

There have been no direct policy statements from the Obama administration on sovereign wealth funds in general or the CIC in particular. However, as a presidential candidate, President Obama stated, "I am concerned if these … sovereign wealth funds are motivated by more than just market considerations, and that's obviously a possibility."[43] The subject of sovereign wealth funds arose during a November 2009 hearing of the Senate Committee on Banking, Housing, and Urban Affairs. During her confirmation hearing, Marisa Lago, nominee for Assistant Secretary for International Markets and Development for the U.S. Department of the Treasury, responded to a question about sovereign investments by saying, "Sovereign wealth funds are not just a private sector investor, but rather are arms of government."[44]

(...continued)

of the Oxford SWF Project at Oxford University.

[41] CRS interview with CIC representative, March 2010.

[42] "CIC to Expand Morgan Stanley Stake," *Zacks Equity Research*, September 1, 2010.

[43] "Obama Says Concerned about Sovereign Wealth Funds," *Reuters*, February 7, 2008.

[44] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Nomination Hearing*, 111th Cong., 1st sess., November 5, 2009.

The CIC's investments in the United States are currently subject to two main forms of regulatory review, one by CFIUS and the other by the SEC. In addition, inward FDI in specific industries or markets – including investments by the CIC – may be subject to laws and regulations governing those particular industries and/or markets.[45]

The Foreign Investment and National Security Act of 2007 (P.L. 110-49) broadened the investigatory authority of CFIUS in cases of national security risk, and increased the committee's reporting requirements to Congress. However, some analysts have suggested that the recent changes do not adequately protect the United States from economic risks posed by SWFs and/or inward FDI from China. These potential economic risks are seen as including financial market instability, undesirable foreign control or influence over key industries or companies, access to sensitive technology, and other forms of unfair competitive advantages. Among the regulatory changes that have been suggested are:

- Requirements that any SWF interested in investing in the United States publicly release audited financial statements that follow international accounting standards on a regular basis;
- Restrictions on the percentage of a U.S. company that an SWF may own (other governments have such limits; for example, Hong Kong authorities have said they may withdraw the authority of Standard Chartered Bank to issue Hong Kong currency if the share of its stock owned by a Singaporean SWF exceeds 20%);
- Restrictions on the type of investment SWFs may make in U.S. companies—alternatives include restricting SWFs to the purchase of nonvoting shares, banning SWFs from negotiating a seat on the company's board of directors or representation in the company's senior management; and
- Changes in U.S. tax code—under current U.S. law, the profits of SWFs are generally tax-exempt; it has been suggested that the tax-exemption for SWFs be eliminated or restricted.

In addition, policy analysts have suggested that access to U.S. financial markets should be contingent on the successful conclusion of a reciprocity agreement that would allow U.S. banks and financial institutions comparable access to the other nation's investment and financial markets.

However, some observers are concerned that increasing the regulatory constraints on SWFs could precipitate a period of global financial protectionism.[46] In addition, China might respond to additional restrictions on Chinese investments in the United States by restricting U.S. FDI in China or U.S. companies' access to China's financial markets. The issue is whether the value of protection obtained outweighs the forgone benefits of investments prevented in more restrictive global and/or Chinese financial markets.

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[45] CRS Report RL33103, *Foreign Investment in the United States: Major Federal Statutory Restrictions*, by Michael V. Seitzinger.

[46] Edwin M. Truman, "Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications," Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, November 14, 2007.

Appendix. The CIC's Holdings of Companies, Investment Funds, and Index Funds

(as of December 31, 2009)

	Company Holdings (61)	
Abbott Labs	Aetna Inc.	American Eagle Outfitters
American International Group	AMR Corp.	Anadarko Pete Corp.
Anglogold Ashanti Ltd.	Apple Inc.	Arcelormittal SA
A123 Sys Inc.	Bank of America Corp.	Blackrock Inc.
Burlington Northern Santa Fe	Chesapeake Energy Corp.	Citigroup Inc.
Coca Cola Co.	Comerica Inc.	CSX Corp.
Cummins Inc.	D R Horton Inc.	Expeditor International Wash. Inc.
Fidelity National Financial	Freeport-McMoran Copper & Gold	Gold Fields Ltd.
Goodyear Tire & Rubber Co.	Hartford Financial Services Group	Ingersoll-Rand
Johnson & Johnson	Kar Auction Services Inc.	Keycorp
Kinross Gold Corp.	KLA-Tencor Corp	Lilly Eli & Co.
Lincoln National Corp.	MEMC Electrical Materials Inc.	Merck & Co.
Metlife Inc.	Morgan Stanley	Motorola Inc.
Navistar International Corp.	News Corp.	New York Community Bancorp Inc.
Noble Corp.	Pfizer	Potash Corp.
Precision Castparts Corp.	Pulte Homes Inc.	Research in Motion Ltd.
Smith International Inc.	Shanda Games Ltd.	Sprint Nextel Corp.
Teck Resources Ltd.	Terex Corp.	Tesoro Corp.
Textron Inc.	United Health Group Inc.	Valero Energy Corp.
Vales S. A.	Visa Inc	Weatherford International
Wells Fargo & Co.		
	Investment Funds (14)	
Market Vectors Gold Miners ETF	Select Sector SPDR Consumer Discretionary Fund	Select Sector SPDR Consumer Staples Fund
Select Sector SPDR Healthcare Fund	Select Sector SPDR International Energy Fund	Select Sector SPDR International Financial Fund
Select Sector SPDR International Industrial Fund	Select Sector SPDR Materials Fund	SPDR Gold Trust Gold Shares Fund
SPDR Series Trust S&P Oil & Gas Exploration & Production	SPDR Trust Series 1	
	Index Funds (7)	
iShares MSCI Japan Index Fund	iShares FTSE/Xinhua China 25 Index Fund	iShares MSCI Emerging Markets Index Fund
iShares MSCI EAFE Index Fund	iShares Russell 2000 Index Fund	iShares S&P Global Energy Sector Index Fund
iShares S&P Global Materials Sector Index Fund		

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