

SUMMARY OF THE REPORT ON SOVEREIGN WEALTH FUNDS AUTHORED BY
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Sovereign wealth funds (SWFs) are not a new phenomenon. They are attracting attention today due to the conjunction of three trends: (i) the growing scale of the assets they manage (from 3,000 billion dollars today to over 10,000 in 2013); (ii) the rapid diversification of these assets into shareholdings—sometimes significant—in quoted foreign companies; and (iii) the creation of funds by new non-OECD member states with pronounced geopolitical ambitions, Russia and China especially.

I. THE INELUCTABLE EMERGENCE OF SOVEREIGN WEALTH FUNDS IS RAISING LEGITIMATE QUESTIONS, BUT IT IS A FUNDAMENTALLY POSITIVE PHENOMENON.

1. The rise of Sovereign Wealth Funds (SWFs) is an irreversible phenomenon. This is because it flows from two deep-seated trends, namely rising raw materials prices, and the structural nature of current account surpluses. Similarly, the emergence of SWFs as front-rank investors, and in particular as significant shareholders of large western firms, is the logical consequence of the diversification of their assets. The issue for France is to assess this phenomenon without preconceptions, in order to make the most—for its economy and its businesses—of a process still only in its infancy.
2. Because it is so new, this process is raising questions. Apart from questions about the governance and aims of these funds, there does appear to be one particularly legitimate concern, namely the risk that foreign investors controlled by their national government might secure direct or covert control of firms deemed to be strategic. This risk is at the centre of the controversy aroused by recent transactions in all parts of the world, e.g. in the United States (the attempted acquisition of UNOCAL by CNOOC and of port operators by Dubai Ports World), in Europe (a rumoured bid by Gazprom for Centrica and the acquisition of 5% of EADS by VTB), as well as in the Asia-Pacific region (Temasek's interest in Shin Corp., and Chinalco's interest in BHP Billiton).
3. In response to these misgivings, it is important to bear in mind that virtually all of these attempted takeovers were made by state-owned corporations, not by SWFs. While it is possible to distinguish among SWFs those that are “portfolio managers” (ADIA, GPF Global, GIC f.i.) that mainly invest according to global asset allocation criteria, and “investment funds” (Mubadala, Temasek, QIA f.i.) which act more in accordance with strategic criteria, the fact remains that, unlike companies, state-owned ones notably, these funds lack the means to formulate a plan to wield industrial control.
4. From this point of view, the creation of funds by countries like China or Russia is a positive development: these funds are far less likely to serve as a vehicle for industrial takeovers than are state-owned corporations; they create a climate for dialogue between investors and western firms.

SWFs can play a positive role within the international financial system both for their countries of origin and for host countries. Their long-term investment horizon is particularly welcome for the funding of essential investments such as infrastructures, and allows companies to take the long view in planning their development.

Finally, they are a particularly valuable investor in the current financial crisis, as witnessed by their acquisition of stakes in several blue chip financial institutions.

II. FRANCE ENJOYS A NUMBER OF SPECIFIC ADVANTAGES IN ATTRACTING SOVEREIGN WEALTH FUNDS

1. The G7 has asked the IMF and the OECD to draw up a code of best practices for adoption by the SWFs and for the countries in which they invest. This work is now well in hand and France is rightly supporting it, in keeping with the European position put forward by the Commission.
2. Over and beyond this support in principle, France nevertheless needs to spell out its position more precisely, having due regard to two factors:
 - (i) Due to the shortcomings in our national savings, notably in equities, France and its companies have a structural need for foreign long-term investors. France's major corporations are well aware of this and actively prospect for foreign investors—the major SWFs notably—through their road shows in particular;
 - (ii) For the SWFs, France is just one investment destination among others, which means it has to compete with its main partners to attract these investors.
3. France can point to three major attractions for SWFs:
 - (i) It has firms and sectors of excellence corresponding particularly well to the SWFs' investment priorities, e.g. infrastructures, telecommunications, transport and services;
 - (ii) A foreign investment control regime limited to clearly-defined sectors, applied with restraint and ensuring a high degree of legal security to investors, whereas most of France's partners, the United States especially, take a far more restrictive approach;
 - (iii) The absence of any discrimination or regulation specifically aimed at the sovereign funds, in our regulatory or legislative framework or securities legislation.

III. POLICY AIMS FOR FRENCH STRATEGY

To benefit from the growth of the SWFs, French strategy needs to pursue three aims:

- To establish a confident dialogue with the SWFs;
- To foster a productive dialogue for our firms and our economy;
- To base this dialogue on the principle of reciprocity.

A/ ESTABLISHING A CONFIDENT DIALOGUE WITH THE SOVEREIGN WEALTH FUNDS

France's main weakness is the way in which it is perceived, namely as a country still reluctant to welcome financial investors, and the SWFs especially. This perception is utterly at odds with the true nature of our economy and our legislative and regulatory framework.

Rather than radically overhauling its regulatory system, France should be giving priority to clearly defining what it expects from the SWFs, as well as what it can offer them.

1. Clearly defining what it wants from SWFs. To lay the foundations for this confident dialogue, it is a necessary and sufficient condition that sovereign funds wishing to invest in France agree to clarify three points for us:

- What are their investment criteria ?
- What role do their political authorities play in defining and conducting their investment policy?
- How do they view their role as shareholder?

The means of communication used matter little. What counts is for all of the parties concerned to have a clear view of the position of the sovereign wealth funds on these three points.

2. No discriminatory treatment of sovereign wealth funds. France—and ideally its European partners—should make one simple commitment, namely to reject all discrimination against sovereign wealth funds as investors. This commitment should have two practical consequences in particular:

- the same regulations should apply to SWFs as to other institutional and financial investors, notably hedge funds and private equity funds;
- the best practice rules to be formulated by the OECD should apply to the SWFs.

3. Formalising reciprocal undertakings with the SWFs in Paris, in the second half of 2008. Paris should extend a welcome to all SWFs wishing to take part in this approach. There are two aims here: to put an end to the current climate of mutual suspicion and send a strong signal of welcome to these investors.

The European Union (of which France will be holding the Presidency in the second half of 2008) should of course be fully involved in this approach.

B/ FOSTERING A PRODUCTIVE DIALOGUE FOR FRENCH FIRMS AND THE FRENCH ECONOMY

4. Promoting the French economy's long-term investment sectors. Promoting the French economy and French firms to the SWFs should focus in the first place on promotion of the country's long-term investment sectors, where it enjoys special expertise.

This could also concern areas not yet adequately covered by the markets, e.g. renewable energies, "second-stage" equity financing. The *France Investissement* scheme, bringing together public and private-sector players to fund the growth and development of SMEs, could be opened up to the SWFs.

Finally, the Caisse des Dépôts has carved out a unique historical position as a long-term investor in the French market and could therefore offer opportunities for partnerships to foreign public-sector investors. The Caisse des Dépôts could develop a network of long-term investors including SWFs to foster productive investment in France.

5. Strengthening French policy of exerting influence in the direction of the SWFs. France has a large number of finance professionals with internationally acknowledged expertise. As the SWFs establish internal advisory and governance structures, France should actively promote the involvement of French professionals in these structures. Organisations such as Paris Europlace could play a major role in this process.

C/ ROOTING THIS DIALOGUE IN THE PRINCIPLE OF RECIPROCITY AT THE NATIONAL AND COMMUNITY LEVELS

Opening the doors to SWFs and rejecting any form of discrimination against SWFs does not mean France should neglect the protection of its essential strategic interests. The basic rule here should be application of the principle of reciprocity with respect to opening the door to French investors (6.), regulation of foreign investments (7.) and takeover regulations (8.).

This aim should notably be adopted in order to permit effective exercise of France's fundamental right to object to any takeover prejudicial to its national strategic interests. This appears to be very much the case within the framework of the existing law.

6. Promoting the principle of reciprocity for access by French and European investment into the SWFs' countries of origin. The counterpart to opening up is access for French firms to the SWFs' countries of origin. Reciprocal does not mean identical. However, it does imply the need for these countries to make significant progress regarding their foreign investment regimes. The present situation is unsatisfactory in many countries. This asymmetry needs to be rectified. One aim of the French Presidency of the European Union must therefore be to achieve significant progress in the ongoing trade negotiations, and in particular with the Gulf States Cooperation Council countries, China and Russia.

7. Basing all European foreign investment regulation for each sector on the principle of reciprocity. Two scenarios should be rejected in responding to the development of the SWFs: namely ad hoc regulation specifically aimed at this type of investor; and an overhaul of the French foreign investment regime, which appears to be proportionate and appropriate. In any case, there would be no Community consensus in favour of a European mechanism to control foreign investment granting wide discretionary powers to a specific authority.

On the other hand, it may be legitimate to initiate discussions on the definition of strategic sectors at the European level requiring specific regulation of foreign investment, examples being energy and infrastructure.

France should be open to this reflection provided any new European regulation is based on the principle of reciprocity: access by foreign investment to the specific sectors will be conditional upon reciprocal access for Community investments. That way it would be possible to guarantee symmetrical progress in non-discriminatory opening up of markets to foreign investments.

8. Applying in full the principle of reciprocity with respect to securities regulation. France has opted to include the reciprocity clause when transposing the Community Takeover Directive into French law. This means that in the event of a takeover bid, the target company is allowed to take appropriate defensive measures if the bidder seeking control does not offer the same guarantees in terms of governance.

This regulation applies to the SWFs as well as to all other investors. France must draw all the consequences that this entails. If more targeted changes to french stock market regulation are required, these should be weighed in the light of these two principles, namely reciprocity and non-discrimination between investors.

REPORT
TO THE GOVERNMENT OF FRANCE

ON

SOVEREIGN WEALTH FUNDS

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Introduction

The emergence of sovereign wealth funds (SWFs) on the international financial scene is not a new phenomenon. Kuwait set up its Kuwait Investment Board, with responsibility for investing the country's oil surpluses, 55 years ago. More recently, Norway established a Petroleum Fund in 1990, which was succeeded by its Government Pension Fund-Global in 2006, a sovereign wealth fund designed to set aside a share of oil revenues for future generations of the Kingdom.

Sovereign wealth funds are attracting attention today due mainly to the conjunction of three trends, namely:

- the growing scale of the assets they manage (3,000 billion dollars today), bearing in mind that these assets will in all probability continue to grow, perhaps even accelerating in the coming years and possibly rising to 10,000 billion dollars in 2013 according to the IMF;
- the rapid diversification of their assets, leading them to increase their investments in foreign quoted companies, and even in some cases to seek to acquire significant shareholdings in these companies;
- the creation of funds by new state actors, as the traditional actors, i.e. the Gulf States, Norway and Singapore, are joined today by Russia and China, and tomorrow by several emerging powers enriched by exports of raw materials (Brazil, Libya, Algeria, and Venezuela, for example).

In place of the traditional image of Middle Eastern funds investing primarily in US, and more recently European, government bonds (cf. the petrodollars of the 1970s, as well as the adjustment loan by Saudi Arabia to France in 1982 to defend the franc), we are now seeing the less reassuring arrival of funds dependent on non-OECD member governments with clear geopolitical ambitions. These funds are not averse to taking direct stakes in Western companies, including in areas that could be considered strategic. It is this change of nature that has aroused misgivings in several G7 countries.

The German Chancellor, among other political leaders, summed up the concerns this trend is arousing as follows: *"The question is whether the acquisition of a shareholding by a fund endowed with state-owned capital arises from a desire to exercise a political influence"*.

The G7 has taken up the issue and in October 2007 asked the international financial institutions, and in particular the IMF and the OECD, to spell out a body of best practices concerning the sovereign wealth funds themselves, but also the countries hosting their investments.

As these institutions are now publishing their interim report on their work, and the French prepare for their presidency of the European Union as from July 1, 2008, the French Minister for the Economy has requested that France spell out its position on this issue precisely, having due regard to the requirements of reciprocity that could be imposed on these funds' country of origin, and simultaneously, to the preservation of France's complete openness to foreign investment.

That is the purpose of this report. Part one starts by recalling the chief characteristics of sovereign wealth funds (I) and then describes the work currently being carried out by the international institutions on this theme (II.). Part two describes the legal framework and issues relating to sovereign wealth funds for France (III.), before going on to present proposals to the Minister that could be adopted in defining our strategy with regard to these major players in the international financial system (IV.).

**PART ONE: SOVEREIGN WEALTH FUNDS, MAJOR NEW
PLAYERS IN THE INTERNATIONAL FINANCIAL SYSTEM**

**I. SOVEREIGN WEALTH FUNDS: AN INELUCTABLE AND POSITIVE
DEVELOPMENT THAT IS RAISING POLITICO-STRATEGIC QUESTIONS**

A. Definition and typology of sovereign wealth funds

1. Definition of sovereign wealth funds

As defined by the IMF in its 21 March report on the subject, sovereign wealth funds (SWFs) are government-owned investment funds that satisfy the following three criteria:

- they are owned or controlled by a national government;
- they manage financial assets in a long-term perspective;
- their investment policies seek to achieve precise macroeconomic objectives such as intergenerational saving, diversification of national GDP, or smoothing economic activity.

Their resources stem from the accumulation of current account surpluses that may themselves result either from exports of raw materials, as in the Middle East, Norway or Russia, or from a structural national saving surplus, as with Singapore. More indirectly, some central banks (as in the case of China) may transfer part of their foreign exchange reserves to these funds.

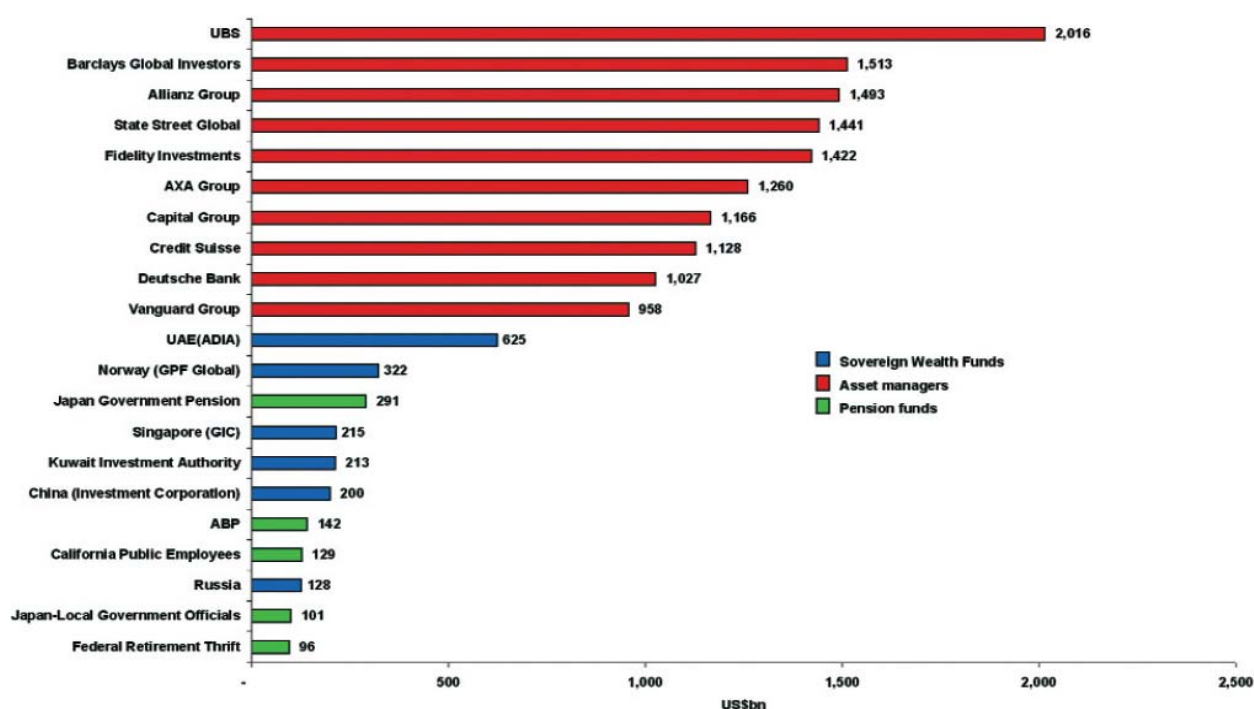
Consequently, SWFs are the result of two deeplying and indeed partly linked trends in the international economic system, namely rising raw materials prices and the structural nature of some countries' current account surpluses. In all likelihood, therefore, their resources will continue to grow.

SWFs need to be distinguished from other public investment entities, e.g.:

- central banks: even though they may retain functional links, as in the case of China or Norway, whose funds are managed by a central bank department on behalf of the Finance Ministry, sovereign wealth funds are distinct in two respects: their aim, which is investment and not the management of monetary policy or foreign exchange policy, and their portfolio, which is more heavily invested in equities, the central banks being required to hold a certain quantity of liquidity in order to cope with foreign exchange-rate variations and therefore hold the bulk of their reserves in bonds;
- government pension funds, which derive their resources from contributions, generally have no direct link with the government and have future financial commitments, their aim being to fund the pensions of future generations, as in the case of the Pension Reserve Fund in France or CALPERS in California;
- state-owned enterprises that take the legal form of companies and not investment funds, and whose prime function is to produce goods and services, not investment.

The precise value of the funds managed by SWFs can only be estimated, since governments rarely disclose figures or not at all. However, the IMF estimates it at between 2,200 and 3,000 billion dollars. A Morgan Stanley estimate puts the figure at 2,900 billion dollars in assets under management, representing precisely double the figure for hedge funds, but nearly 20 times less than the global stockmarket capitalisation of 50,800 billion dollars (according to the October 2007 GFSR report).

Chart 1 – Main institutional investors by assets under management



Source: Oxford Analytica, Watson Wyatt.

2. Typology of sovereign wealth funds

Appendix 3 presents a list and characteristics of the main sovereign wealth funds.

These may be distinguished in the first place according to when they were created, enabling identification of the different phases in the evolution of SWFs.

Historically, SWFs made their appearance in the Gulf States (United Arab emirates, Kuwait and Qatar), Norway and Canada, in answer to the need for structures to invest the proceeds of commodities exports, oil and gas in particular. The Singapore funds, Temasek formed in 1974 and GIC in 1981, pursue the same long-term logic, although based on resources resulting not from trade in raw materials, but from a trade surplus, and above all the sizeable imbalance between saving and investment (36 billion dollars, or 27% of GDP in 2006), resulting from the high level of domestic saving (53 billion dollars or 40% of GDP in 2006), and relatively low public investment.

The second generation of SWFs has emerged much more recently, marked by the creation of investment funds by major geopolitical actors such as China and Russia (see box 1). As we shall see, it was very much on the occasion of the emergence of this second generation that SWFs have come to be seen as a major issue. Not because of their specific characteristics or of any particular investment strategy, but because of the geopolitical ambitions of the governments that control the new funds. For it is clear to all that, independently of the amounts managed by these funds, the political and strategic stakes are not the same when these funds are managed not by small States with small populations (Singapore and all of the Gulf States have a total population of around 12 million inhabitants, excluding Saudi Arabia), but by front rank states such as China or Russia. Their recent emergence and the resulting absence of any significant history of investment in OECD countries cannot fail to amplify the questions raised on this point.

The third generation is very much in the making. It is, or rather will be tomorrow, made up of funds created by the emerging countries with structural surpluses on exports of commodities. There are several projects underway apart from Saudi Arabia, which after long hesitation, announced in April 2008 the creation of a first fund with an initial capital of 5.3 billion dollars (for the record, the Saudi central bank's reserves stand at approximately 300 billion dollars). Others include Brazil, which

in early May stated its intention to create a 20-billion dollar sovereign wealth fund (representing 10% of its foreign exchange reserves), notably with a view to supporting investment by Brazilian firms abroad. Tomorrow's sovereign wealth funds will be set up by new powers such as Venezuela, Libya or Algeria.

It is important, secondly, to consider their investment strategy. Not all investment funds have chosen to invest outside their frontiers. Khazanah, for example, the Malay investment fund, with a capital of 25 billion dollars, invests domestically only. SWFs become an issue only when they invest abroad. Their investment strategy or strategies are not easy to define, due partly to the great diversity of existing situations, but also to the dearth of available data on these strategies. At the risk of oversimplification, we shall nevertheless attempt to distinguish two main approaches.

Those we call "portfolio managers", whose strategy consists primarily in diversifying their investments based on global criteria aimed at outperforming benchmark indexes, with no overt sector specialisation or desire to become involved in the management of the companies they invest in. This approach, which is fairly close to that of pension funds, seems to characterise the best-established funds such as those of Abu Dhabi (ADIA, with an estimated 625-875 billion dollars under management), Norway (GPF Global with 380 billion dollars under management) or Singapore (GIC, with an estimated 215 billion dollars under management). It should be noted that this is also the proclaimed approach, at this stage, by Russia's oil stabilisation fund, which gave rise in February 2008 to the National Fund for Well-Being (see Box 1).

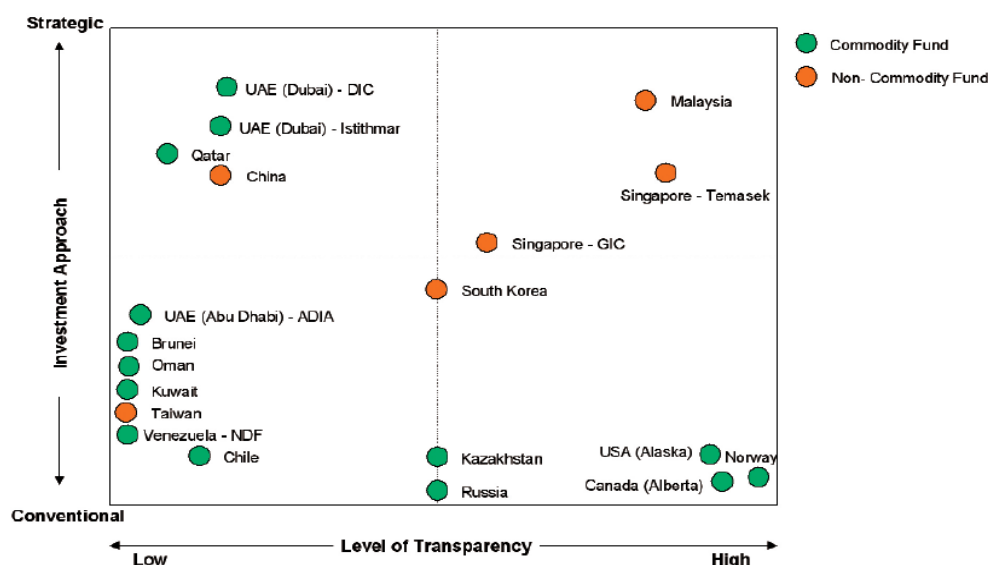
Next come those we shall call "investment funds", which differ from the foregoing by the definition of their investment criteria, making more room for sector specialisation, depending on the government's strategic choices. This is the case with Singapore's Temasek, Abu Dhabi's Mubadala, or the Qatar Investment Authority. While applying a rigorous investment methodology, these seek to invest in strategically important sectors for their countries' development. The strategy of Dubai's investors, such as Dubai Holding and Dubai World, which can also take the legal form of companies, appears to be relatively close on certain points, targeting shareholdings allowing them to form industrial partnerships. These pursue a twofold aim, namely to develop projects in the Emirates with the partner providing technology (as in the case of the alliance with Total to manage the Qatar-Emirates gas pipeline, for example); and also to facilitate access to the third countries' markets thanks to introductions by the partner.

An example of this second strategy concerns sectors such as semi-conductors (as in the case of Mubadala's 8% stake in AMD), car manufacturing (with Mubadala's 5% stake in Ferrari), aerospace, financial services (e.g. QIA's 20% interest in the LSE, and the 97% investment by Borse Dubai in OMX, which was sold in February 2008 to Nasdaq in return for a minority stake in the US exchange, and a cross-shareholding for the latter in the Dubai Stock Exchange), together with infrastructures and energy.

In this configuration, and although this is not a general rule, investments are larger and hence more concentrated, with greater involvement in the management of the companies in which the funds invest.

The chart below illustrates this distinction, with "investment funds" seeking to take a more strategic approach than the "portfolio managers".

Chart 2 -- The investment policy of the main sovereign wealth funds



Source: Standard Chartered and Oxford Analytica

Finally, we consider the means available to these funds to manage their investments. Here again, the situation varies for each fund. However, it is possible to identify a general trend, namely that their human and material means are very limited relative to the amounts under management. Confining ourselves to three examples, ADIA, the Abu Dhabi sovereign wealth fund, has only 1,100 employees to manage an estimated 625 to 875 billion dollars in assets; CIC, the Chinese SWF created in September 2007, currently employs only 150 people; finally, the Qatar Investment Authority reportedly employs fewer than 50 investment professionals. Since it is generally considered that 2 support function employees (administration, compliance, middle/back office) are required for each investment professional, these figures give some idea of the slender means at the disposal of most SWFs. A portion of these funds can of course be managed by third parties, as provided for institutionally in the case of the Norwegian fund managed by a department of the central bank, or as a result of management mandates. Nevertheless, these means are not generally sufficient to permit active involvement by the funds in the management of the companies they invest in, over and beyond their function as a professional investor.

B. A fast changing role

1. The place of SWFs is undergoing a change of nature

a) The new actors: the emergence of Russia and China

The first development identified above is the proliferation of SWFs. Until recently, SWFs belonged to States most of which were located in the Gulf and to Singapore. Only two OECD Member States, Norway and Canada, held SWFs of any significant size.

However, 20 new SWFs have been created since 2000, 12 of them since 2005 (see list in appendix 3). The most important of these have been created by new actors who are not members of the OECD (nor even of the WTO in the case of Russia), with known geopolitical ambitions. This development is fundamentally altering the nature of the debate on sovereign wealth funds. Consequently, Box 1 below briefly presents the salient features of the SWFs established in the recent period by Russia and China.

Box 1: the Chinese and Russian sovereign wealth funds

1/ CIC, the Chinese sovereign wealth fund

China officially created the China Investment Corporation (CIC) on 26 September 2007, with an initial capital of 1550 billion CNY (more than 205 billion dollars). This capital is comprised of special Treasury bonds issued for maturities of 10 to 15 years and carrying interest at between 4.3 and 4.45%.

In addition to this remuneration the fund pays administrative costs, which therefore implies a minimum target annual return for CIC of around 6-7%. The Chinese SWF will therefore need to take not insignificant risks in order to exceed the return obtained by the SAFE, the central bank institution responsible for the management of the foreign exchange reserves, which recently took a 1.6% stake in the capital of Total.

CIC's investment capacity is far less than the 205 billion dollars transferred to it, this amount having been split into three equal parts:

- 70 billion dollars were required to acquire the assets of Huijin (the Chinese central bank's bank recapitalisation vehicle), within the framework of the merger between the two entities;
- another third, or 70 billion dollars, was originally supposed to be devoted to the recapitalisation of Chinese banks (notably 20 billion dollars for CDB, and 40 billion dollars for ABC bank);
- the final third, again 70 billion dollars, is available for international investments. This amount was recently increased to 90 billion, the recapitalisation of the banks proving less costly than expected.

2/ The Russian funds

Russia announced on 1 February 2008 that it was splitting its petroleum stabilisation fund into two, namely a reserve fund and a fund for National Well-Being:

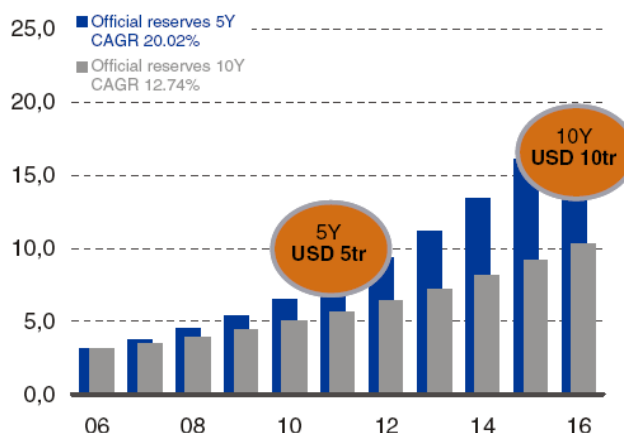
- a 125-billion dollar reserve fund (representing 10% of Russian GDP), which is the heir to the former stabilisation fund and intended to play the same role of sterilising liquidity entering Russia and stabilising the budget in the event of a slump in commodities prices. The terms of use of this fund are identical to those applying to the stabilisation fund, namely 45% of the fund to be invested in dollar assets, 45% in euro-denominated assets, and 10% in GBP assets. 50% of resources are to be placed in sovereign bonds, up to 30% in foreign and public agencies' or central banks' debt securities, and up to 5% in the IFI's debt securities.

- a Fund for National Well-Being, endowed with 32 billion dollars at its creation, whose purpose is to contribute to the funding of the pension system deficit. Its management rules have not yet been spelled out, but they are expected to be so before 1 October 2008. Pending this, the same management rules are applied as for the reserve fund. An internal debate is reported to be going on between the Finance Ministry and other ministries and interest groups over the use of these funds, notably the share to be allocated to investments abroad and in Russia, and the class of securities that can be acquired with these resources.

b) Growth forecasts for assets managed by the SWFs

According to IMF projections, assets managed by the SWFs in 2013 will total between 6,000 and 10,000 billion dollars, while other estimates are higher. One published by Morgan Stanley in May 2007 forecasts a total amount under management of 12,000 billion dollars by 2015. Consequently, the most conservative estimate forecasts a doubling over the next five years. This growth will come in the first place from continuing exports of commodities by the SWFs' countries of origin, its actual extent obviously depending on price trends for these commodities.

Chart 3 – Forecast growth in assets under management by SWFs



Source: Bank for International Settlements, DB Research

However, for the longest-established funds, income from investments can in some cases represent amounts comparable to those resulting from exports of commodities. In the case of the Kuwait Investment Authority for example, the return on financial holdings abroad represented 40% of the income derived from oil exports in 2007.

These convergent factors point to a certainty, namely that, far from being a transient phenomenon, the role of the SWFs in the international economy is a structural fact whose importance will grow for the foreseeable future.

b) Diversification into more strategic shareholdings

This trend results from three factors.

In the first place, it reflects a classic asset diversification strategy leading to a greater weighting in equities and, more marginally, in other riskier asset classes, notably commodities. The aim of this diversification is to achieve higher returns and brings the SWFs' investment policy closely into line with that of the major Western fund managers such as pension funds, for example. This stands in opposition to foreign exchange reserves investment policy, which focuses more on guaranteed yield products such as bonds. Among others, for example, the Norwegian fund adopted guidelines in 2007 increasing the equity weighting in its benchmark portfolio from 40 to 60%.

Secondly, the trend reflects the acquisition of significant shareholdings, ranging between 2 and 10%, in major Western firms. The purchase in recent months of convertible bonds issued by leading American and European financial institutions is the most salient example of this (see Point I-B-2-c below). This is not the first occurrence, however. Confining ourselves to Europe, such major firms as Vivendi, EADS, Daimler-Chrysler, and now Total, now number identified sovereign wealth funds among their shareholders, with representation on their boards of directors, as in the case of Vivendi, for example. Also worth noting is that in many cases this investment is the outcome of a proactive approach on the part of the company, seeking the support of a long-term shareholder.

Finally, the emergence, as mentioned above, of investment funds pursuing partnership strategies aimed at reaping the industrial and/or technological benefits for their country of origin, which may involve taking significant stakes such as those, mentioned earlier, in the capital of AMD or the LSE.

Table 1 – Examples of significant shareholdings

SWFs	> 5% shareholding in a company with a capitalisation of > 2 Bn dollars	> 2% shareholding in a company with a capitalisation of > 10 Bn dollars
ADIA	<ul style="list-style-type: none"> - 9% of Apollo Management (Private Equity, United States) 	<ul style="list-style-type: none"> - 4.9% in Citigroup (bank, United States) - 2% of Mediaset Spa (media, Italy) - 8% of EFG-Hermes Holding (investment bank, Egypt)
Mubadala	<ul style="list-style-type: none"> - 7.5% of Carlyle (Private Equity, United States) - 8% AMD (semiconductors, United States) 	
GIC		<ul style="list-style-type: none"> - 9% UBS (bank, Switzerland) - 4% of Citigroup (bank, United States)
Temasek		<ul style="list-style-type: none"> - 2% in Barclays (bank, United Kingdom) - 18% of Standard Chartered (bank, United Kingdom) - 9.9% of Merrill Lynch (investment bank, United States)
CIC		<ul style="list-style-type: none"> - 9.9% of Blackstone (private equity, United States) - 9.9% of Morgan Stanley (investment bank, United States)
KIA		<ul style="list-style-type: none"> - 4% of Merrill Lynch (investment bank, United States) - 6% of Citigroup (bank, United States) - 7% of Daimler (car manufacturer, Germany) - 2% of BP (energy, United Kingdom)
QIA	<ul style="list-style-type: none"> - 20% of LSE (stock exchange, United Kingdom) - 5% of Lagardère Group (media, France) 	<ul style="list-style-type: none"> - 25% of Sainsbury (food retailer, United Kingdom)
DIC		<ul style="list-style-type: none"> - 2% of Daimler (car manufacturer, Germany) - 3% of EADS (aerospace and defence, Netherlands)

2. The positive contribution of sovereign wealth funds to the international financial system

SWFs play a fundamentally stabilising role in the international financial system, a view clearly in evidence in the course of the current liquidity crisis.

This positive role works to the benefit of both recipient countries and the funds' countries of origin.

a) The positive role of SWFs for the country of origin

SWFs act as a kind of provident insurance in their country of origin by transferring part of the rent to generations to be born after the country's natural resources have been depleted. SWFs thus enable their country of origin to diversify their sources of GDP by developing new activities (e.g. the development of a leisure and tourist industry in Dubai, or Mubadal's strategy of developing activities unrelated to raw materials in Abu Dhabi), and by constituting a source of regular income independent of oil and gas, whose reserves are limited.

They play a stabilising role by cushioning against a temporary drop in commodity prices. The fact of setting up an investment fund serves to generate annual income disconnected from commodity price fluctuations, so as to offset falls when they occur. Beyond oil market swings, SWFs also serve to offset adverse shocks to the economy, along the lines of the fund for future generations managed by KIA, from which around 100 billion dollars (in 1990 dollars) were drawn down to pay for the country's reconstruction after the Iraqi invasion.

b) The positive role of SWFs for host countries

By reallocating foreign exchange reserves from Government bonds to equities, SWFs allow countries that save to invest in the productive economy of net borrower countries rather than fund their public debt.

Above all, SWFs are long-term investors. They provide the enterprises in which they acquire a stake with long-term funding that guarantees them the security they need in order to grow their business and withstand cyclical downturns. This investment approach, made possible by the long-term and predictable nature of their resources, is especially desirable for the financing of essential investments.

Consequently, SWFs can contribute to the development of countries that host their investments by contributing to the funding of infrastructures, for example. It was with that in mind that the President of the World Bank, Robert Zoellick, recently proposed to the SWFs that they invest 1% of their assets in African companies, in conjunction with the World Bank.

c) An invaluable investor in a time of financial crisis

As they rightly point out, the SWFs have no responsibility for the current financial crisis. On the contrary, they have helped to cushion its consequences. After all, the SWFs had no hand in the "subprime" crisis. This was primarily a liquidity crisis that spread from low-grade mortgage-backed securities to a large number of asset classes. More precisely, the big western banks exposed to credit default risk contagion have had to recognise hefty writedowns, leading to a liquidity crisis.

It is this shortage of liquidity that the SWFs have helped to fight by helping to recapitalise ailing financial institutions. In the space of six months they have invested a total of 66 billion dollars in the capital of western financial institutions, usually in the form of convertible bonds.

That is the case example with the Chinese CIC fund (which invested 5 billion dollars in Morgan Stanley, representing 9.9% of its capital), the Singapore funds GIC (which invested 10 billion dollars in UBS, or 9% of its capital and 7 billion dollars in Citigroup, 4.5% of the bank's capital) and Temasek (which invested 4.4 billion dollars in Merrill Lynch, or 9.9 % of its capital), and Emirates funds (an investment of 7.5 billion dollars by the Abu Dhabi ADIA fund in Citigroup, representing

4.9% of its capital). Clearly, the risk of systemic contagion in the financial crisis would have been far greater had the SWFs not been able to acquire these stakes. It is equally clear that these investments do not flow from any initial desire on the part of the SWFs, but well and truly from active approaches by the financial institutions concerned: their managers personally and actively solicited the SWFs' involvement in these recapitalisations.

To date, no SWFs has expressed a wish to become directly involved in the governance of these financial institutions. In particular, none of them has asked to be represented on the board of directors, even though the scale of their investments would have made any such request legitimate to say the least.

3. Controversies revealing politico-strategic rather than purely economic concerns

a) A series of controversial transactions

The debate over the legitimacy and motives of investments being made by foreign public entities, over and beyond the case of SWFs, came to the fore in the wake of a series of emblematic transactions that have occurred since 2005. It is worth recalling the timeline of these transactions.

- In August 2005, the Chinese state-owned enterprise CNOOC was obliged to abandon its plan to take control of the oil company Unocal under pressure from the American authorities, notably at the initiative of the House of Representatives. The latter asked the President to scrutinise the transaction on the grounds that it might pose a threat to national security. CNOOC's withdrawal led to the abandonment of the review procedure instigated by the House Committee on Foreign Investment in the United States (CFIUS).

- In January 2006, the Singapore fund Temasek tried to acquire Shin Corp, the leading Thai media company. This operation sparked fierce controversy in Thailand, with public opinion accusing the Prime Minister, who had links with Shin Corp, of selling off national champions cheaply. This led Temasek to reduce the size of the stake it acquired to 42%.

- In May 2006, the transfer of six American ports to the United Arab Emirates' state-owned company Dubai Ports World, which had been approved by the CFIUS, sparked a strong response in Congress leading to the abandonment of the transfer as well as to the reform of this mechanism, completed in 2007 (see Appendix 8).

- Also in May 2006, rumours of a bid by Gazprom for the UK company Centrica led the British Minister for trade and industry, Alan Johnson, to announce his intention to subject the transaction to "robust scrutiny", marking a clear break with the traditional attitude of the UK authorities of avoiding public statements on mergers and acquisitions and takeovers.

- In September 2006, the Russian state-owned bank VTB acquired 5.02% of EADS. This unsolicited investment prompted concern in both France and Germany over the possible existence of strategic motives. It should be noted that the financial institution's Chief Executive subsequently stated: "I can swear on the Bible that this is a purely financial investment." Whatever the case, VTB sold its stake in EADS in December 2007 to another Russian state-owned bank, VEB, acting on behalf of the Russian state holding company OAK.

These five transactions have three common features: they involved state-owned foreign investors, concerned enterprises operating in sectors deemed to involve the strategic interests of States (energy, defence and infrastructures), and did not take place in a consensual manner, if not directly with the enterprise concerned at least with the stakeholders as a whole. This was particularly the case in the United States, where the abandonment of the CNOOC and Dubai Ports World transactions resulted from political pressures, particularly in Congress.

No doubt one can see in these operations a reflection of Western countries' concerns over the risks attendant on foreign investments liable to affect national strategic interests, notably in the case of direct or indirect takeovers of companies considered to be of strategic importance. The debate and the international initiatives regarding SWFs are the direct outcome of these concerns.

Yet there is a paradox here: with the exception of Temasek for the acquisition of Shin Corp and, to some extent, of Dubai Ports World, which can be regarded as a sovereign wealth fund even though legally it is a state-owned company, none of these transactions was initiated by SWFs as previously defined here. In all cases they concerned state-owned enterprises directly controlled by foreign governments.

This comment also applies to the most recent transactions, the latest among them concerning the mining sector in Australia. Rumours of the acquisition by the Chinese of a stake in the mining company BHP Billiton over and beyond the 9% shareholding acquired in February 2008 by Chinalco, a Chinese state-owned company associated in this instance with Alcoa, are presumably not unrelated to the publication by the Australian authorities of guidelines for implementation of the Australian foreign investment controls regime in the case of a state-owned investor. According to the press, the Australian government has invited at least 10 Chinese companies to relinquish their investments in the Australian natural resources sector. Here again, the debate concerned acquisitions of strategic shareholdings by state-owned enterprises and not by SWFs.

The debate is not entirely new: the British government had forced KIA in 1988 to dispose of a substantial portion of its shareholding in British Petroleum. On the other hand, the scale of the recent controversies is unprecedented.

b) Politico-strategic rather than economic concerns

The foregoing leads to an initial conclusion, namely that the most crucial issue clearly concerns the real motives of a foreign investor controlled by its national government and seeking to take control of enterprises considered to involve national strategic interests.

This concern arises from two postulates.

In the first place, the idea that a national foreign investor may have aims other than the pure maximisation of its financial investment. Other factors leading to the decision will be taken into account, such as promoting national interests e.g. financial or energy independence, encouraging technology transfers and moving national industries upmarket, along with policies pertaining to regional and international influence.

In the second place, the capacity to take control of or at least exercise real influence over companies touching on national strategic interests. There is little doubt as to this capacity when we are dealing with a quoted enterprise. The answer is less obvious in other cases, and raises two questions, in our view:

- is the acquisition of a minority interest in a company's capital, particularly in the absence of involvement in the firm's governance and notably with no representation on the board of directors, really an effective means of exercising real influence over the firm and benefiting from industrial, technological and strategic transfers?
- is an SWF really the most appropriate vehicle to provide its national government with these transfers? Does it have the means and the capacity for this? Or wouldn't a state-owned enterprise, a genuinely industrial firm, be better placed to benefit from this industrial expertise, market knowledge and necessary strategic vision?

Undoubtedly there can be several answers to the first question, while the answer to the second is clearly negative. This is not to say that the issue of SWFs is not worth discussing, quite the reverse. But it does mean that the essential question of protecting national strategic interests with respect to foreign investments cannot be addressed through this prism alone. It notably entails the need to consider a) the wide variety of strategies for exerting influence that do not involve acquiring stakes in firms, and b) the role of state-owned enterprises, which are probably better-placed than investment vehicles like SWFs to manage an industrial project with control of the firm concerned.

In that respect, the creation of funds by countries like China and Russia can be seen as a positive development: these funds are far less likely than state-owned enterprises to serve as a vehicle for the acquisition of industrial controlling stakes. In addition, they provide a channel for dialogue between investors and western companies.

II. SOVEREIGN WEALTH FUNDS, A NEW INTERNATIONAL SUBJECT

A. The involvement of the international financial institutions

The G7 was quick to take a position on the question of SWFs. After rapidly broaching the issues at their meeting on 13 April 2007, the item has been on the agenda of all subsequent meetings of the G7 Finance Ministers. At the Annual General Meetings of the IMF and the World Bank on 19 October 2007, the G7 asked the various international financial institutions to investigate the question with a view to defining a set of best practices for application to and by the SWFs and the countries hosting their investments.

1. *The IMF: framing a list of best practices*

The IMF has been invited to consider the transparency and financial stability aspects, and to draw up a list of best practices for the use of SWFs. The Fund proposed a work agenda that was adopted by the Board of Governors of the IMF on 21 March 2008 (see Appendix 5).

The IMF report's agenda is considering proposing best practices rather than a code of conduct, which would be less binding in its normative scope. These best practices would apply to SWFs on a voluntary basis. Under the G7 mandate, these practices would centre around three aspects, namely transparency, whose degree is a matter of debate, institutional arrangements and governance, with a view to ensuring the independence of the SWFs' management along the lines of the central banks.

The precise definition of these best practices should be arrived at in consultation with the IMF member countries, after identifying current practices. The following work timetable has been adopted for the coming months: creation of a working group, followed by a round table in April notably involving the SWFs, a first draft of best practices for August, a second consultation, and finally a document for the AGMs in Autumn 2008. The round table took place on 30 April and 1 May and lead to the creation of a working group to formulate the future best practices (see composition in appendix 5).

As noted in the IMF work agenda, this consultative approach is close to the one adopted for the work begun in 2007 concerning other financial investors, namely the alternative investment funds (hedge fund) and the leverage investment funds (private equity funds), which are discussed below.

Box 2: Studies on "private equity" and "hedge funds"

1/ The Walker group on Private Equity

The report by the working group chaired by Sir David Walker, prepared at the request of the British Private Equity and Venture Capital Association (BVCA), sought to answer public criticisms of private equity activity by framing a code of conduct intended to enhance the transparency of this activity. The report, published on 20 November 2007, defines principles for large British enterprises controlled by private equity funds (an annual report published on the website, indicating the identity of the funds controlling the enterprise and disclosing information concerning the activity and performance of the enterprise), and for the funds themselves (publication on the website of an annual report notably indicating the companies under management and the types of investors).

The Walker report's proposals are not mandatory but are adopted on a "comply or explain" basis. This approach means that companies that do not adopt the report's proposals would be required to justify themselves publicly, which is consistent with current UK governance practice applicable to quoted companies.

The BVCA announced on 19 November 2007 that this group was to be set up under the chairmanship of Sir Michael Rake, Chairman of the Board of Directors of British Telecom. This group, comprised of five members (three of them independent and two representing the private equity sector) would have the power to expel from the BVCA those investment management firms that fail to comply with the code of conduct. This is a matter of debate among the private equity firms. The group met in March 2008 to define the framework for the report's implementation. Several private equity groups (including TerraFirma and Permira) that previously did not publish their reports have now done so on their websites.

2/ The Large group on Hedge Funds

The report prepared by the British working group on hedge funds, chaired by Richard Large, was published on 22 January 2008. This defines a certain number of best practices voluntarily adopted by hedge funds concerning disclosure of information to investors and counterparties, asset valuations, prudential questions and risk management, and rules of governance.

These principles have been adopted by 14 hedge funds, which took part in their framing and have called on the other hedge funds to do likewise. Compliance with these practices will be communicated to the Hedge Funds Standards Board according to the "comply or explain" principle, but the Board will have no powers to enforce application of the principles and will not monitor them. The Board has met once since January 2008, and is working to ensure that the managers of UK-based funds state whether or not they intend to subscribe to the report's recommendations by December 2008.

Similar initiatives, following the same approach, have been taken in other forums, as in the case of the US President's Working Group on financial markets set up to frame best practices for private investment funds, including hedge funds and private equity funds.

This method consists in bringing together professionals to define best practices for voluntary adoption, and its proper application is subject solely to peer pressure; it is akin to the one proposed by the IMF, the only difference being that the Large and Walker groups consisted solely of professionals, to the exclusion of the authorities or international financial institutions.

Without prejudging the outcome of these proceedings, the IMF's role should presumably be judged at least as much according to the degree to which it effectively involves the different actors, the SWFs foremost among them, and according to the actual quality of the consultation, as in the light of the final documents that emerge.

2. The OECD: host countries' investment policies

The OECD, meanwhile, is investigating questions relating to investment regimes and national security. Its contribution consists in adapting to the question of SWFs the more general principles that the Investment Committee began formulating back in 2006 as part of its work on the theme of government restrictions on investment in strategically important sectors.

The purpose of this project is to help governments in achieving their aim of protecting national security while avoiding unnecessary or disproportionate restrictions on investment. In 2007, the OECD identified four principles (non-discrimination, transparency, predictability and proportionality) to be respected by all member states in applying their controls on foreign investments. These principles were adopted by the G8 Heads of State and Government at Heiligendamm on 6-8 June 2007.

The aim of the current work of the OECD Investment Committee is twofold: to transpose the principles identified for all foreign investments to the question of SWFs, and to establish detailed best practices for each principle.

To respect the principle of transparency, Member States undertake to adopt the following guidelines: codification and publication of restrictions; prior notification of any changes in investment policy; consultation with the parties concerned in the event of any change in investment policy; equity and predictability of procedures, which should notably provide for strict deadlines; and disclosure of action taken within the framework of the investment policy.

Concerning the principle of proportionality, a reminder is given that the essential concerns relating to security are a matter for the governments' own discretion, that measures should be precisely targeted and formulated with adequate expertise, adapted to the risks incurred and implemented as a last resort.

The final report on the project as a whole will be ready by mid-2009 at the latest. An initial specific report on the question of SWFs was validated by the Investment Committee on 1 April, and was formally adopted by the Executive Committee at a special session on 5-6 May. It was presented on the occasion of the Ministerial meeting of 4-5 June, chaired by the French Minister.

Like the IMF, the OECD begins its report by identifying the principles already existing in the OECD codes binding on all Member States. In addition to the principles of non-discrimination (the principle of national treatment) and transparency (information on restrictions must be accessible), which have been included in the work of the Investment Committee, the OECD codes also lay down the principles of progressive liberalisation (elimination of restrictions), status quo (prohibition of new restrictions), and unilateral liberalisation (non-reciprocity).

3. A general framework that needs to be supported and completed

The involvement of the IMF and the OECD, at the G7's behest, provides an opportunity to offer the SWFs a kind of implicit pact based on an exchange between the best practices in transparency and good governance that they are urged to adopt within the IMF framework, and the principles that the OECD Member States are equally invited to adopt in order to create a favourable environment for investments by the SWFs.

It thus has the merit of distributing the burden of new constraints among the industrialised countries and the emerging countries, so as to avoid giving the impression that the current debate will end up imposing additional obligations on the SWFs.

However, this framework creates three imbalances.

In the first place, although this is of secondary importance, there is a difference in timing between the best practices to be defined by the IMF for the coming autumn 2008 AGMs and the OECD principles, which will not be available until mid-2009.

Secondly, there is an imbalance as to the binding character of commitments. The OECD principles relating to foreign investment, as spelled out with regard to investments by SWFs, will be mandatory for that organisation's Member States. Conversely, the IMF's list of best practices will merely be proposed to the SWFs on a voluntary basis, and it does not look as if it is possible to envisage any kind of binding character at this stage.

Finally, and this is probably the most important point, no provision is made regarding the foreign investment regime in the SWFs' countries of origin, when these are not members of the OECD.

It so happens that this concerns all of them with the exception of Norway. This is no doubt the most sensitive point in the eyes of public opinion, and rightly so. How can one justify opening up to investment by SWFs if the reverse is not possible, or at any rate not to the same degree? The President of the French Republic reaffirmed before the UK Parliament on 26 March his support for "free trade and at the same time (...) the defence of our interests, expressing the wish that in Europe we understand the meaning of the word reciprocity". Appendix 9 sets forth the main restrictions on foreign investment for certain sectors in the countries of origin of sovereign wealth funds. It clearly emerges from this that the degree of openness to foreign investment in OECD Member States, and hence France, is out of all proportion to that generally prevailing in the SWFs' countries of origin. Part two of this report presents proposals aimed at remedying this situation.

B. Other approaches, Community and bilateral

1. The Community approach

Nearly 6 months after the G7 referred the issue to the OECD and the IMF, and in the light of the plans of many OECD member countries, Germany in particular, to introduce tougher foreign investment control regimes, the Commission has proposed a common approach to the question of sovereign wealth funds to the Member States. These accepted this approach on the occasion of the European Council on 13-14 March in Brussels.

Formulated in a Communication released on the 27 February (see Appendix 7), the Commission's position is the outcome of several months of internal discussion between the different competent Directorates-General, Trade, Market and Ecfm foremost among them. It was important that the Commission avoid two pitfalls on the question of SWFs, namely protectionist initiatives by Member States in response to inactivity by the Commission, and the risk that any European regulation centred on the control of SWFs activity might project a restrictive image.

The resulting document takes a balanced approach. It justifies the need for a common European position by the impact that a single position among all 27 Member States would have, the need to maintain the openness and coherence of the internal market in order to preserve its attractiveness, and the importance of avoiding protectionist temptations so as not to undermine requests to our partners for greater openness.

The Commission proposes to contribute to the work being undertaken by the IMF and the OECD aimed at compiling a list of best practices applicable both to the SWFs and to host countries. It is notably taking part in the IMF working group and the OECD Investment Committee. Attention is drawn to two aspects in particular, namely: governance (with reference to the IMF Guidelines for Foreign Exchange Reserve Management, and the OECD Guidelines on Corporate Governance of State-Owned Enterprises) and transparency, the Norwegian fund being cited as an example here.

2. The bilateral approach: the case of the United States

On a strictly bilateral basis, the United States brought together representatives of the American, Singapore and Abu Dhabi governments on 20 March 2008, together with representatives of these two countries' SWFs (respectively GIC and ADIA), with a view to adopting a joint statement notably defining a number of principles that the participants (SWFs and host countries) pledge to respect.

In its general economy and in the content of the principles it sets forth, this agreement partly prefigures the outcome of the study entrusted by the G7 to the IFIs, at least regarding the framework of principles for adoption by both the funds and the host countries. On the other hand, the principles set forth in the American agreement do not coincide precisely with those on which the international financial institutions are currently working.

For instance, the first principle the SWFs ought to adopt, namely an undertaking to base their investment decisions on commercial and not on geopolitical considerations, is not mentioned as such in the IMF's work agenda. In greater detail, the table below compares the principles announced in the European Commission Communication with those in the IMF work agenda and, finally, with the US-Singapore-Abu Dhabi agreement.

Table 2 – Comparison of proposed best practices for sovereign wealth funds

Best practices	European Commission Communication	IMF Work Agenda ¹	US-Singapore-Abu Dhabi Agreement
Transparency			
Declaration stating that investments are made on purely commercial grounds	No	No	Yes
Annual publication of investment positions and asset allocation	Yes	Yes	Yes ²
Exercise of voting rights	Yes	No	No
Publication of use of leverage and currency breakdown	Yes	No	No
Publication of fund's investment aims	No	Yes	Yes
Extent and source of resources	Yes	Yes	No
Publication of country of origin's regulations and surveillance of fund	Yes	Yes (disclosure of institutional arrangements)	Yes (disclosure of institutional arrangements)
Governance			
Distribution and separation of responsibilities in internal governance of the fund	Yes	Yes	Yes
Adoption and publication of an investment policy setting forth the fund's investment aims	Yes	Yes	No
Existence of operational autonomy allowing the fund to achieve its aims	Yes	Yes	No
Publication of general principles concerning relations between the fund and the government	Yes	Yes	No
Publication of general principles	Yes	Yes	No

¹ At this stage, this concerns the principles already set forth by the IMF for other actors, which could also apply to the funds. The definitive list of best practices is expected to be published in time for the autumn AGMs.

² The declaration does not state that funds are required to adopt these principles, but it does say that they help to reduce financial markets uncertainty and build relations of confidence with the host countries.

of corporate governance guaranteeing integrity			
Adoption and publication of risk management policies	Yes	Yes	Yes (adoption, not publication)
Level playing field with the private sector	No	No	Yes
Compliance with host country's standards	No	No	Yes

The American agreement is designed to be more operational and less institutional than the European Commission and IMF approaches. Presumably, also, it more closely matches actual investment practice, even if certain principles are clearly redundant, notably the one concerning compliance with the host country's standards. Two examples can serve to illustrate this point:

- Minimum publication requirements, notably regarding the definition of the fund's investment aims, the scale and source of its resources, or again the use of leverage and the currency breakdown. It is important to realise here that, on these two points, transparency represents a direct cost to investment funds if they publicly disclose their investment strategies, which could be exploited by competitors hence putting them at a competitive disadvantage: for example, disclosing one's level of debt will inform other investors about one's sensitivity to the credit market and interest rates. This information can legitimately be disclosed to investors in the fund; it is hard to imagine other financial investors spontaneously providing this kind of information to the market. The same comment applies to the breakdown by currency of the different assets.
- As a counterpart to the affirmation of the principle that investments should be based on purely commercial considerations, the US agreement has less to say about best practices providing greater details of the fund's internal management, such as the degree of its operational autonomy, or the publication of general principles of internal governance.

**PART TWO: DEFINING THE POSITION AND STRATEGY OF
FRANCE TOWARDS SOVEREIGN WEALTH FUNDS**

I. THE POSITION OF FRANCE TOWARDS SOVEREIGN WEALTH FUNDS

A. An imperative: the attractiveness of France vis-à-vis the sovereign wealth funds

1. France has a structural need for long-term investors like the sovereign wealth funds

This has been noted too frequently to warrant further comment. Due its low level of national saving, as reflected in its current account deficit and the low proportion of assets held by nationals in the form of equities, France is particularly in need of investors, notably to finance the capital of its enterprises. Evidence of this can be found in the share of non-residents in the capitalisation of French enterprises, with foreign investors holding 47% of the capitalisation of the CAC 40, versus 52% for the DAX 30 in Germany and 40% for the entire UK stock market.

The SWFs are especially well suited to the needs of the French economy because of their long-term perspective. Indeed many SWFs are already present in the French economy and in the capital of major French firms, sometimes with significant shareholdings. For example, Dubai International Capital holds 3% of EADS, Qatar Investment Authority 5% of Lagardère, ADIA and the Kuwait Investment Authority are also shareholders of Vivendi. Just recently, SAFE, the body that manages the reserves of the Central Bank of China, announced that it had acquired a 1.6% stake in Total. Without going into details, it is clear that in many cases the firms themselves have directly solicited this investment. This is because an SWF offers three highly attractive characteristics as an investor for a quoted firm:

- a long-term investment horizon;
- they are large enough, financially, to be able to consider taking a significant stake, generally on the order of a few percent, with no liquidity risk;
- their investment management style precludes an activist or aggressive approach to the company's management.

France and French firms are competing very directly with the other leading euro zone markets and their firms to attract investment by the SWFs. As we shall see below, France enjoys a number of undeniable advantages in this competition, as well as weaknesses not to be overlooked.

This competition currently extends to the location of the European offices of these funds. A good illustration is the European tour organised last December by the Chair of China Investment Corporation, Mr. Lou Jiwei. He notably visited Paris and London, and both capitals focused their message on the advantages for the Chinese fund of setting up a European office in their respective cities, even though the creation of any such office had not yet been announced. CIC is continuing to study the two possibilities, and the UK Chancellor visited China in mid-April to boost London's candidature, among others. Also worth noting in this respect is the announcement by the Qatar Investment Authority of its intention to open a representative office in Paris in order to oversee its property investments.

The French economy needs investment by the SWFs for the effective funding of its businesses. It is in its interests to send out a message that it is open to all foreign investors, and more particularly to the sovereign wealth funds. France's large firms indeed are fully conscious of this and are actively promoting themselves to the leading SWFs, through road shows among others.

2. A persistent gap between perceptions and the reality of French openness to foreign investments

a) Perceptions of France need to be improved

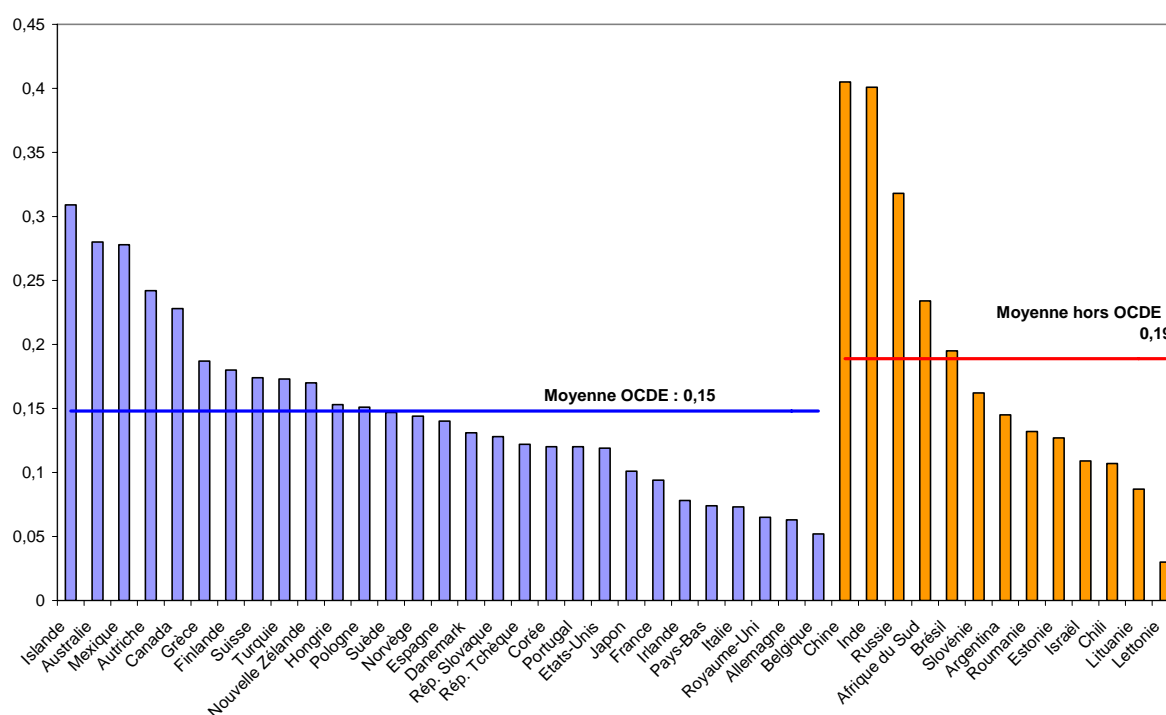
France's interlocutors still view the country as reluctant to welcome financial investors, including SWFs. This image has fortunately been rectified, in particular by the President in his speech to the business community in Riyadh on 14 January, when he said that France was "open to sovereign wealth funds" if their intentions were "unambiguous" and their governance "transparent".

The first priority of the French authorities in dealing with the SWFs, therefore, should be to dispel perceptions that the country is closed to investors. That image would be especially detrimental to France since it is far removed from both the reality of its economy and the legal regime applying to foreign investment in France.

b) An economy genuinely open to foreign investment

In the first place, it does not reflect the actual degree of openness of France to foreign investment, including by comparison with its European or G7 partners. According to the OECD index of openness to foreign investment, France ranks better than Japan, the United States and Canada.

Chart 4 – Regulatory restrictions on foreign direct investment



Note: By construction, the index of restrictiveness lies between 0 and 1. All sectors of the economy.
Source: Koyama and Golub (2006)³.

³ This index measures regulatory restrictions in 9 sectors and 11 sub-sectors, including telecoms, distribution, finance and construction. Each type of restriction is weighted by a coefficient, ranging from 1 (ban on foreign capital) to 0.025 (movements of people limited to 3-4 years). Similarly, the sectors are weighted, from 0.192 (business services) to 0.019 (electricity).

The fact is that France is more open to international investment than the aforementioned countries, thanks to a combination of three contractual mechanisms:

- European integration with the other EU Member States;
- the EU's bilateral free trade agreements, e.g. with Chile;
- WTO commitments vis-à-vis third countries that include the investment regime, via the establishment of a trade presence, one of the four forms of service provision laid down in the General Agreement on Trade in Services.

Foreign Direct Investment (FDI) in France was again very high in 2006, at 64.6 billion euros⁴, roughly on a par with the record set in 2005 (65.2 billion euros), which was more than double the 2004 figure.

3. A policy to promote the attractiveness of France well suited to the needs of sovereign wealth funds.

Since 2003, France has put in place a comprehensive policy aimed at improving the country's attractiveness, which is being implemented by the Invest in France Agency (IFA). The IFA has undoubtedly helped to improve the image of the French economy in the eyes of the SWFs. These funds take a highly positive view of this mission, and it deserves to be pursued and amplified.

The first point to note here—and this is very positive in its own right—is that foreign investors recognize and appreciate this policy. None of them has mentioned any particular difficulties standing in the way of their investment projects in France, nor were any specific legislative or regulatory changes mentioned. This observation is evidence of the quality of the work being done to publicise and promote our policy regarding the attractiveness of France, notably by the IFA. This suggests that this policy is generally well suited to the situation and that there is no need for any fundamental overhaul of our legal framework. Obviously this does not rule out continuing our efforts to modernise the legal framework. For example, moves to make Paris more attractive as a financial centre, within the framework of the work being done by the Paris Financial Services High Level Committee, represent a key objective in facilitating the arrival of SWFs.

Four types of reform could be particularly useful in this respect.

In the first place, measures (tax measures in particular) to adapt to the requirements of Islamic finance, which could encourage banks and financial institutions from the Arabian peninsula to set up in Paris, in particular for investment and asset management activities. This should favourably influence the funds' allocation choices.

Secondly, the signing of tax conventions with the emerging countries that have set up SWFs would facilitate economic relations between the partners' different entities. As an example, it is planned to conduct negotiations with China and Russia in 2008 with a view to improving existing conventions.

Thirdly, reforming securities law in order to facilitate access by foreign practitioners. At this stage, the Paris Financial Services High Level Committee is considering simplifying the nomenclature of financial instruments, combining within a single book of the Monetary and Financial Code all of the relevant provisions currently dispersed throughout the Code, and modernising and simplifying the wording of certain provisions.

Finally, promoting the French asset management industry. With more than 2,500 billion euros under management, this is the largest such industry in Europe. It owes this position to

4 Source: Banque de France – Balance of payments and external position– Annual report– 2006

acknowledged French expertise in financial mathematics and modelling, as well as to a robust and innovative regulatory framework. The draft economic modernisation act currently under discussion in the French Parliament plans to allow UCITS aimed at qualified investors and for export to receive approval on the basis of a prospectus published in another language than French, to overhaul the framework for French-law closed funds (fixed-capital investment companies, which can be quoted and which were created in 1945), and to adjust the framework for alternative UCITS, notably by allowing contractual UCITS to invest in all types of assets and to define their selling and purchase procedures at their discretion.

All of these measures are aimed at further enhancing the attractiveness of France as a destination for foreign investment and consolidating the role of Paris as a financial centre.

B. The foreign investment regulation matches the SWFs' expectations

1. The French foreign investment control mechanism

France no longer exercises any general control over foreign investment. By a government decree of 30 December 2005, it instituted a regime of prior authorisation limited to a certain number of sectors. More precisely, foreign investment in French enterprises whose activity comes under one of the 11 sectors (7 in the area of public security⁵, 4 in that of defence) listed in the decree are subject to prior authorisation by the Minister for the Economy.

It is worth recalling, for the record, that specific limits can be placed on the acquisition of shareholdings by foreign investors in certain sectors such as telecommunications or the media. Pursuant to the 30 September 1986 Act, as amended by the 5 March 2007 Act on the modernisation of audiovisual broadcasting and the television of the future, foreign individuals or corporations are prohibited from directly holding more than 20% of the issued capital or voting rights in shareholders meetings of a company holding a licence for the terrestrial broadcasting of French-language radio or television programmes. Moreover, foreign shareholdings in companies producing publications in the French language may not exceed 20% of the company's capital or voting rights.

a) A system providing legal security for foreign investors

What investors seek above all is stable and predictable regulation. The existence of a foreign investment regime as such is not the problem; what can discourage investment is uncertainty as to which rule applies and how it is applied.

The French regime provides security in three ways, in this regard:

- The sectors subject to authorisation are defined both precisely and in a restricted manner, eliminating all possibility of extensive interpretation to embrace new areas of activity;
- The investor can question the administration before engaging in a transaction in order to verify whether the planned operation effectively falls within the scope of the decree, providing him with the necessary visibility before making his investment decision;

⁵ Gambling, regulated private security activities, activities relating to the means required to deal with the illicit use of pathogenic or toxic agents, activities concerning devices designed to intercept correspondence and for the remote detection of conversations; service activities within the framework of approved evaluation centres, activities relating to the security of the information systems of an enterprise linked by contract with a public or private operator managing installations of vital importance, activities relating to certain dual-use goods and technologies.

- The Minister's decisions can be appealed, and the absence of reply after two months' consideration constitutes approval, thereby guaranteeing the investor against any risk of protracted procedures preventing an operation being carried out.

More than two years after its adoption, this mechanism has been applied with restraint, with no sign that any particular operation has escaped its purview.

In its first two years of application, the Minister has ruled on 69 transactions (31 in 2006, and 38 in 2007), 68 of them in the four sectors relating to national defence and a single operation for the seven sectors relating to public security. The Minister has not listed a single rejection, and has asked the investor to give undertakings in a little over one case in two. In all cases, the investor has given these undertakings.

These undertakings are primarily intended to protect the security of supplies for defence programmes, for example the continuity of ongoing contracts or the maintenance on French soil of critical assets indispensable to these supplies. No appeals have been made against these decisions.

Altogether, the picture could hardly be more satisfactory, since no investment has been rejected and investors have agreed to give all of the undertakings requested. In addition, no investor has expressed any criticisms either of the principles underlying this regulation nor of its application.

b) The mechanism is compliant with Community legislation

French regulations in this area were based on the terms of the Treaty establishing the European Community, whose article 58 provides for the possibility of exemptions from the free movement of capital for the purpose of taking “measures which are justified on grounds of public policy or public security”, and whose article 296 states that “any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material”.

In replying to complaints formulated by the Commission in its reasoned opinion of 18 October 2006, France is currently putting the finishing touches to the necessary adjustments to ensure that this decree is fully compliant with Community law. Two modifications are being made to that end:

- The exclusion of casinos from the regime, given that the transposition of the third anti-money laundering directive will allow France to adopt a similar mechanism to the controls on foreign investment in this sector;
- The restriction of the scope of indirect control, currently applied to the three cases of investment laid down in the decree, leading to two European firms being treated differently depending on whether the first is controlled by a company from a third country and is thus subject to the regime applicable to third party investors provided for in the decree, while the second firm is controlled by a Community country company and is thus subject to the regime reserved for European investors.

The forthcoming conclusion of the negotiations now in progress between the French authorities and the Commission on these two points is expected to result in the termination of the Community proceedings against this decree.

Indeed there is a striking contrast between the controversies in France and abroad that marked the framing and subsequent application of this regulation, and the consensus now surrounding it among international investors two years after it came into force.

The legal security it provides is all the more significant in that many of our partners have taken a far more restrictive line with respect to their regulations applicable to foreign investors in the recent period.

2. International developments in the regulation of foreign investment: towards a more restrictive approach

Several countries, including some of France's main trading partners, have recently begun reviewing, or have even already modified, their regulation. The general trend is clearly towards greater restriction, whether in defining the sectors subject to authorisation or even the adoption of regulations specific to the SWFs or, more broadly, to all investors controlled by foreign governments.

a) A definition of sectors providing a lower level of legal security

Several countries have opted to list sectors more comprehensively (more than 30 sectors in Japan, 42 sectors in Russia in the latest version of its bill), representing so many restrictions on foreign investment. The Japanese regime, for example, makes foreign investment in the electricity, gas and thermal energy distribution sectors as well as trade in oil and gas, subject to authorisation. The Chinese system makes foreign investment in key industries subject to authorisation, and prohibits it in sectors such as the media or air-traffic control.

These systems frequently embrace energy and infrastructures, unlike in the French system.

Other States have chosen not to draw up a list of sectors in which foreign investment is subject to ministerial approval. This type of arrangement leaves the authorities with very broad discretion to react to a planned foreign investment in a strategic enterprise, but to the detriment of the investors' legal security.

This is notably the case in the United Kingdom, where the 2002 Enterprise Act on the Control of Concentrations provides that in the event of moves liable to affect "national security", the Industry Minister can order an investigation by the Office of Fair Trading and subsequently by the Competition Commission. After that, the Minister can seek undertakings on the part of the entities concerned, block operations in progress, or even order a break-up.

When the German authorities decided in summer 2007 to broaden their regime, which was limited at the time to the defence sector alone, they opted for a general reference to investments liable to affect "public order and public security", renouncing the principle of a list by sectors. Work is still proceeding on this planned amendment, which has not yet been adopted by the German Cabinet.

Clearly, in this respect, the American system of foreign investment controls for all transactions liable to affect "national security", without further explanation, gives the US authorities extremely broad latitude to determine whether a planned foreign investment should be subjected or not to the CFIUS procedure described in Appendix 8.

b) The introduction of regulations specifically applying to investors controlled by foreign governments

In view of the controversies aroused by transactions like the ones discussed above, and in particular the Unocal and Dubai Ports World affairs, several major powers have considered introducing regulations explicitly targeting investors controlled by foreign governments, the SWFs foremost among them.

The reform of the US system, signed by President Bush on 26 July 2007, and which took effect on 24 October 2007 (see Appendix 8), provides for the automatic addition of a 45-day investigation to the initial 30-day review period in the case of an investor owned or controlled by a foreign government, or if a critical infrastructure is concerned, unless the Treasury Secretary, who chairs the CFIUS review committee, and the head of the Department or agency with competence for the transaction, who is also a member of the CFIUS, jointly determine in the light of the 30-day review that these transactions will not affect national security. Moreover, the number of cases scrutinised by the CFIUS has increased sharply since the controversy over the acquisition of US ports by Dubai Ports World in 2006. The number of cases was 147 in 2007, compared with 65 in 2005.

In addition, again under pressure from Congress, on 21 April 2008 the US Treasury published a draft regulation providing for the elimination of the 10% shareholding threshold above which the CFIUS is at present competent, in practice. This change in the Committee's practice, designed to control acquisitions of shareholdings limited to 9.9% (which was the case for several recent stakes acquired in American banks) but resulting in the exercise of a form of control over the targeted company, sends a strong signal of the US Administration's determination to control these investments.

Germany, meanwhile, momentarily envisaged setting up an agency to monitor SWFs, but the Minister of Finance rejected the idea.

Other countries have adopted guidelines spelling out how they plan to apply their regulations to the case of a public foreign investor. This is the case with Australia and Canada, for instance. The guidelines spelled out by Ottawa for example lay down the principle that, in determining whether there is a "clear advantage for Canada" in the transaction, the Canadian government will give consideration to the compatibility of the investor's governance practice with Canadian rules on governance.

By comparison with the mechanisms put in place in the other G7 countries and other European countries, the French system leaves limited scope for discretion by the national authorities and is clearly less restrictive than regulations put in place in the recent period. It is worth recalling and publicising this fact, since it runs counter to the general perception of France's attitude to foreign investment.

Above all, French regulations reserve no special treatment for SWFs, or to state-owned entities in general. It treats all transactions by foreign investors without discrimination and without distinction as to their nature.

1. Securities law compliant with Community legislation

French securities law does not discriminate between French and foreign investors or according to their public or private status. Consequently, SWFs, like any other category of investor, are required to comply with the regime governing the reporting of the crossing of shareholding thresholds upon acquiring 5% of the capital or voting rights of a quoted company, and to issue a statement of intention when they cross the 10% and 20% thresholds, as well as the threshold above which a public cash tender offer must be issued.

The legal regime governing takeover bids is based on the incorporation into French law of the European Takeover Directive (directive 2004/25/EC of the European Parliament and Council of 21 April 2004), as implemented in the French 31 March 2006 Act.

Article 12-3 allows Member States to adopt a "reciprocity clause". This clause has been incorporated into French law in Article L. 233-33 of the Commercial Code.

In the event of an unsolicited takeover bid, this clause allows a French company to take measures to thwart the bid if the bidder company fails to respect the same governance principles as the target company.

Article 9 of the directive requires a vote by the shareholders while the bid is in progress before the anti-takeover measures can be implemented. The reciprocity clause relieves a target firm of

this obligation in the event of a bid initiated by a foreign company that fails to respect this. If the bidder is a company whose shareholders have not approved the taking of defensive measures during the bid period, and if previously authorised by the shareholders, the Board of Directors may take defensive measures without further consultation during the bid period.

A French firm faced with a takeover bid by a foreign SWF can thus claim the benefit of this measure, which is based on the principle of reciprocity. This is because the use of the term “entity” in Article L.233-33 also permits the reciprocity clause to be invoked against all types of bidding entities, such as a company (public or private-law), trust or investment fund. This need not necessarily be a quoted entity, in keeping with the conclusions of the report of the working group chaired by Mr. Lepetit.

The working group also considered that the reciprocity clause could apply outside the Community, in particular vis-à-vis States such as China or the United States, and that it was compatible with France’s international commitments with the framework of the World Trade Organisation (WTO), in particular under the General Agreement of Trade in Services (GATS). Article 2 of the GATS provides for application of the most-favoured nation clause. It was considered that, because the exception on grounds of reciprocity should be assessed with regard to the individual situation of the bidding company and not with regard to the regulations applicable in that company’s country of origin, there was no discrimination on the basis of a criterion of nationality.

Consequently, it must be possible to apply this clause vis-à-vis investors from third countries. It should be noted that the question of the equivalence of measures will be particularly acute in that event. This is because of the risk that bidders will systematically challenge the absence of any equivalence of measures, as invoked by the target to justify its defensive measures. This is especially so in view of the possibility of appealing to the Paris Court of Appeal against the decision of the French Financial Markets Authority (AMF), which is required to rule on this point by comparing the different laws concerned. In that case it would be desirable in practice for the target company rapidly to seek the opinion of experts in the country concerned in the event of a bid by an investor from a third country, in order to ascertain the possibility of invoking the non-reciprocity clause.

The question has also arisen regarding the application of the clause in the event that an investor that does not apply the principle of the competence of the Shareholders’ Meeting for defensive measures were to issue a bid for a French company concomitantly with other entities that do apply the principle. Here, the French system does protect French firms by explicitly providing that the clause can be applied if just one of the bidders acting in concert is not virtuous. The same holds if the bidder is controlled by an entity that does not respect the clause. On the other hand, the clause can no longer apply if the bidder acts in concert with the target.

Consequently, the clause can apply to a SWF, just as it can to other types of investor, but only on the grounds provided for in the decree. This is because French law on public takeover bids makes no provision concerning respect for this or that standard with regard to governance or transparency.

C. France has domestic long-term financial investors.

France has two long-term public sector investors, which means that the logic applied by this type of investor already exists and is recognized in France.

1. The Caisse des Dépôts et Consignations (CDC)

Ever since its origin, the CDC has consistently acted as an institutional investor engaging in financial operations or investments in a long-term perspective. Being legally endowed with stable resources and free from any major liquidity constraint, the CDC has naturally steered its investments towards long-term applications in the service of the economy.

In this function as an investor, the CDC is a state-owned institution backed by an institutional guarantee. Its 1816 bylaws confirm its independence, with a Chief Executive responsible for respecting the patrimonial interests of the institution under Parliamentary protection, via the intermediary of a Supervisory Commission.

In its investments, the CDC seeks to enhance the value of its long-term portfolio. Accordingly it tends to invest more in quoted and unquoted equities, in property and private equity, seeking higher returns than those available from bonds.

It is required to reconcile the demands of long-term investing with the need to generate regular annual earnings, having a duty to generate a sufficient annual profit to discharge its missions with respect to the general interest and the development of the economy. This is because it is obliged to rely solely on its own resources in developing its means of action and preserving the sustainability of its business model. To reconcile this demand for recurring returns and long-term appreciation, it can draw on a range of strengths, and in particular its share capital; the share capital of its subsidiaries operating on long-term markets (insurance, property and transport); stable deposits, notably those of the legal professions; and its financial solidity and credibility. Thanks to these strengths it is able to "follow-through" its investments with no illiquidity risk. Finally, the CDC is a diversified investor.

In this context, the CDC manages a number of portfolios, some held by funds that it manages on behalf of third parties, and others that it manages out of its own capital. Concerning the savings deposits that it manages, its portfolio invested in equities totalled 10.2 billion euros on 31 December 2007. Concerning its capital, the CDC holds a large portfolio managed according to essentially financial criteria, together with strategic shareholdings in enterprises whose development it intends to support, foremost among these being its own subsidiaries. Altogether, it holds 35 billion euros in diversified financial assets (bonds, equities, property and private equity, forests, etc) and around 10 billion euros in the capital of its subsidiaries and strategic shareholdings.

The carrying value of its investment portfolio at 31 December 2007 was 15.7 billion euros, an increase of 1.1 billion euros relative to the previous year. This consists essentially of fixed-rate securities; however, a minority of the portfolio is invested in inflation-linked bonds. The trading and available-for-sale portfolio excluding short-term treasury holdings, is smaller, amounting to 3.4 billion euros at the end of 2006. Its portfolio of quoted equities, built up from the CDC's capital, amounted to 13.5 billion euros (at historical cost). This position should be seen in the context of the total French stock market capitalisation of around 1,230 billion euros for the CAC 40.

The Caisse des Dépôts draws on a body of doctrine and on the recommendations of the advisory committee that advises it on all questions of governance. This committee was set up in February 2004 to formulate a more active CDC presence in the shareholders meetings and boards of directors of companies in which it owns sizeable shareholdings, establishing voting policy regarding the payment of dividends, the granting of stock options, capital increases or reductions, etc., and ensuring compliance with that policy.

Moreover, the Caisse des Dépôts does not generally invest abroad, insofar as its mission is to contribute to the economic development of the French territory and French companies.

The law on the modernisation of the economy, which was examined by the National Assembly in the last week of May 2008, seeks to strengthen the role of the CDC as a long-term investor contributing to the development of companies while upholding its patrimonial interests, by enshrining this role in its remit. It also seeks to modernise its governance by bolstering the prerogatives of the supervisory commission regarding the institution's strategic decisions, by broadening the range of independent personalities, and by providing for the possibility of turning to the Commission Bancaire for assistance in providing prudential oversight of the institution. In addition, it proposes to set up an investment committee with responsibility, among others, for a priori scrutiny of significant investment transactions.

2. The Fonds de réserve pour les retraites (Pensions Reserve Fund)

The Pensions reserve fund has replaced the "old age solidarity fund", set up in 1999. The latter's bylaws and governance were modified in 2001, giving rise to the fund in its present form. Its mission is to manage the funds allocated to it, placing them in reserves until 2020 in order to contribute to the long-term survival of France's compulsory old-age insurance schemes and the aligned farmers' and artisans' pension schemes. It receives its resources from the social levy on

unearned income, surpluses of the “Caisse nationale d’assurance vieillesse” (national old-age insurance fund), and the proceeds of asset disposals such as privatisations.

Its assets under management totalled 33.4 billion euros at 30 June 2007. Its investment policy is shaped by several rules. In the first place the Pensions reserve fund has adopted an investment ratio of 3% on any issuer (excluding unquoted companies, of which in any case it is not allowed to take control, and property companies). According to its latest strategic allocation, dating from May 2006, its portfolio is split as follows: 60% in equities (euro zone 33%, non-euro zone 27%), 30% in bonds (euro zone 21% and non-euro zone 9%), and 10% in “diversified” assets (property, commodities indexes, infrastructures, and unquoted vehicles).

It utilises management mandates selected according to the procedures laid down in the Public Procurement Code. However, since the decision of 26 July 2007 in application of the 21 December 2006 law no. 2006-1640, it can waive these mandates for the following asset categories: property, infrastructures, unquoted companies, emerging companies equities and bonds, and money market instruments.

Its accounts are certified by audit firms and subject to financial control by the State. A summary statement of its assets and performance is published quarterly, and the Fund publishes the breakdown of its portfolio by broad category in its annual report.

Regarding the exercise of voting rights, it follows the detailed guidelines adopted by the supervisory board and made public on 10 February 2005. The Fund has also adopted its own socially responsible investing principles.

II. GUIDANCE FOR A FRENCH STRATEGY: A CONFIDENT AND PRODUCTIVE DIALOGUE FOUNDED ON RECIPROCITY

To define a strategy for France with regard to SWFs it is first necessary to determine its priorities in this debate. These are of three kinds:

- Understanding the aims and expectations of sovereign wealth funds
- Establishing a confident and productive relationship with them
- Basing this relationship on the principle of reciprocity.

These three aims are intimately interwoven: it is necessary to gain greater insight into the investment policies of SWFs in order to be able to enter into a confident dialogue with them. This confidence in turn is a precondition enabling France to demand the application of the principle of reciprocity. Reciprocity is a political priority as stated by the President of the Republic. Indeed the SWFs understand this perfectly. The work requested by the G7 from the international institutions is contributing to the achievement of these aims, by improving our understanding of SWFs and entering into a dialogue with them. It does not fully achieve them alone. Consequently, the position of France cannot be confined solely to support for this process, indispensable though it is.

Emphasis should be placed on three areas in answer to France’s aims: establishing a confident dialogue with the SWFs, using this dialogue for a productive exchange of views, and basing the relationship on the principle of reciprocity.

A. Establishing a confident dialogue with the sovereign wealth funds

France’s main weakness is the perception of it as a country still reluctant to welcome financial investors, and particularly the SWFs. This perception is totally unrelated to the reality of our economy and to our legislative and regulatory framework.

Rather than radically overhauling our regulations, priority should be given to defining clearly what we expect of SWFs and to what we can offer them.

1. Clearly defining our expectations with regard to the sovereign wealth funds.

As a basis for this confident dialogue, SWFs wishing to invest in France should—and this would be sufficient—agree to explain their position on three points:

- What are their investment criteria?
- What is their government's role in the definition and conduct of their investment policy?
- What is their conception of the shareholder's role?

How this is communicated is not important: what counts is that all of the parties involved can obtain a clear vision of the SWFs' position on these three points.

2. Rejecting any discriminatory treatment of sovereign wealth funds.

France, and ideally its European partners, should give a simple undertaking, namely to reject any form of discrimination vis-à-vis the SWFs as investors. This undertaking would notably have two practical consequences:

- Application to the SWFs the same regulations as to other institutional and financial investors, notably hedge funds and private equity funds;
- Application of best practice rules to the SWFs as and when defined by the OECD.

3. Formalising in Paris our reciprocal undertakings with the sovereign wealth funds in the second half of 2008.

We should welcome to Paris all of the SWFs that wish to be involved in this approach, including the oldest established ones (from the Gulf States, Singapore and Norway) as well as the most recent ones (Russia and China, notably). The aim is twofold, namely to dispel the existing climate of mutual misgivings and to send a strong signal of welcome to these investors.

The European Union, whose Presidency France will be holding in the second half of 2008, should naturally play a full part in this approach.

The letter sent by the government of Abu Dhabi to the G7 ministers is an interesting illustration of undertakings concerning ADIA, one of the most prominent SWFs.

Box 3: Letter from the Government of Abu Dhabi to the G7 ministers

In a letter sent to several ministers, including those of the G7, in mid-March 2008, the government of Abu Dhabi spells out its position on the ongoing international debate on the sovereign wealth funds. Recalling that Abu Dhabi's organisations have been active for more than 30 years, the letter confirms the Emirate's readiness to continue its contribution to the work of the IMF.

The government of Abu Dhabi then states that the sole aim of these organisations is to maximise long-term returns, and undertakes never to use these vehicles as foreign policy instruments.

The letter emphasises that transactions are carried out in accordance with international standards (80% of ADIA's funds are managed by outside firms), acting independently and in compliance with the regulations of the recipient countries, and according to appropriate standards of governance and reporting. In addition, the Abu Dhabi funds act primarily as passive investors, the very great majority of shareholdings taken in foreign firms being limited in scale, with no right of control or seat on the Board of Directors, and with no interference in management.

The letter acknowledges the need for host countries to put in place a mechanism to review foreign investments affecting national security, on condition that this mechanism is fair and transparent.

Finally, the government of Abu Dhabi states its willingness to lower its trade barriers and boost cross-border trade.

In thus acknowledging the need for reciprocity while undertaking to refrain from pursuing political goals, this letter from the government of Abu Dhabi stands as an example of the kind of undertakings that could be requested of the SWFs.

B. Fostering a productive dialogue for France's enterprises and economy

4. Promoting the French economy's long-term investment sectors

In promoting the French economy and French firms to SWFs, priority should be given to long-term investment sectors in which we possess special expertise, e.g. infrastructures, telecommunications, transport, and services, for example.

This could also concern areas not yet sufficiently covered by the markets, such as renewable energies, and equity capital for SMEs. The “France Investissement” mechanism, in which public and private sector actors are working together to finance the development and growth of French SMEs, could also be opened up to the SWFs.

Finally, the Caisse des Dépôts has developed a unique historical position as a long-term investor in the French market. As such, it could hold out opportunities of partnerships with foreign public sector investors. By developing a network of long-term investors, including SWFs, the CDC could help to promote productive investment in France.

5. Reinforcing our policy of influence vis-à-vis the sovereign wealth funds

For the most part, boosting France's attractiveness depends on changing the way it is perceived. All of the sovereign wealth funds questioned expressed their satisfaction with the existing regulatory framework and did not request any major alterations. Conversely, the stability of this framework is a positive factor in the choice of an investment destination. As a result, there is no need for any major reform to the existing framework in order to boost the attractiveness of France in the eyes of the SWFs.

However, certain sectors would gain by being developed. This is particularly the case with regard to France's asset management industry, which is directly concerned by the emergence of the SWFs, and Islamic finance. Work is already underway regarding these two sectors of activity, which deserves to be supported and accelerated.

At least as much as its attractiveness, France would gain by bolstering its influence vis-à-vis the SWFs. France has a large number of finance professionals whose expertise is internationally recognized. At a time when the sovereign wealth funds are setting up internal board and governance structures, it would be worthwhile actively promoting the involvement of French professionals in these organs. Organisations such as Paris Europlace could play a major role in this mobilisation.

C. A dialogue founded on the principle of reciprocity

Keeping an open door to SWFs and rejecting all forms of discrimination against these sovereign wealth funds does not oblige France to forgo the necessary protection of its strategic interests. The main emphasis of our approach, therefore, should be the application of the principle of reciprocity regarding the treatment of our investors (6), regulation of foreign investments (7), and the regulations applicable to the acquisition of controlling interests (8).

This emphasis should notably enable France to assert its fundamental right to oppose any acquisition of a controlling interest liable to affect its national strategic interests. This would very much appear to be the case under the existing legal framework.

6. Promoting the principle of reciprocity for access by French and European investments in the sovereign wealth funds' countries of origin

The counterparty to opening our doors is access by our firms to the sovereign wealth funds' countries of origin.

This applies particularly to countries such as China, which despite its accession to the WTO has kept in being a great many barriers to entry in sectors of interest to French firms, such as telecommunications, financial services and construction. This is also the case, albeit in varying degrees, for other States with SWFs (see Appendix 9).

This principle of reciprocity does not mean identity. It does however imply a need for significant progress in these countries' foreign investment regimes. The present situation in a great many countries is unsatisfactory. This asymmetry needs to be remedied by asking our partners owning SWFs to open their doors wider.

That is precisely the goal of the trade negotiations with our European Union partners aimed at obtaining improved market access. France is working with the European Commission for this, since trade policy is the exclusive preserve of the European Communities, barring certain limited aspects spelled out in Article 133-6 of the ECT (cultural and audiovisual services, educational services, and social services and human health).

However, this is coupled with the formulation of a European position in these negotiations, and could serve to support calls for openness in the direction of the countries owning SWFs. This approach is especially relevant, inasmuch as bilateral trade negotiations are already in progress, or are on the point of starting, with several countries owning SWFs. This is notably the case for draft free trade agreements between the Union and the Gulf Cooperation Council (GCC), with Korea and ASEAN, the draft partnership and cooperation agreement with China, and negotiations with Russia surrounding its accession to the WTO.

One of the aims of the French Presidency of the EU should therefore be to achieve significant progress in the current trade negotiations, in particular with the Gulf Cooperation Council, China and Russia.

7. Any European regulation on foreign investment should be founded on the principle of reciprocity

In dealing with the development of sovereign wealth funds, two scenarios should be rejected: that of ad hoc regulation specifically targeting this type of investor; and that of an overhaul of the French foreign investment regime, since this appears to be proportionate and appropriate. In any case, there would be no Community consensus for the creation of a European system to control foreign investments conferring broad discretionary powers on a specific authority, and the Commission explicitly rules this out in its communication.

Conversely, it may be legitimate to open up a reflection on the definition of strategic sectors at the European level, e.g. energy and infrastructures, for example, requiring the adoption of specific regulation of foreign investments.

France should be open to this reflection, provided any new European regulation is based on the principle of reciprocity: access by foreign investors to this or that sector will be conditional on reciprocal access for Community investors. This would guarantee non-discriminatory and symmetrical progress in opening up to foreign investments.

8. Applying in full the principle of reciprocity to securities legislation

As spelled out above, France has opted to retain the reciprocity clause when implementing the Community takeover directive. This allows the target company, in the event of an attempted acquisition of a controlling interest, to take appropriate defensive measures if the company seeking control does not provide the same guarantees in terms of governance.

This regulation applies equally to the SWFs and to all other investors. It can be utilised in cases where its application is legitimate in the face of attempted takeovers.

While more targeted changes to French securities law are necessary, these should be considered in the light of these two principles: reciprocity, and the absence of all discrimination between investors.