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Enhancing the Transparency of Sovereign Wealth Funds: From the Middle East to China

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Abstract: *Sovereign wealth funds, as an active participant in the global capital market, have attracted increasingly more attention from both academicians and practitioners. The opacity of the funds is one of the hot issues. A greater transparency is needed for the Sovereign Wealth Funds (SWFs) in the Middle East when they play an increasingly important role in the global capital market. By reviewing the transparency standards and examining the performance of SWFs in the region on information disclosure, this article lists the political, economic and cultural causes of the opacity and justifies the varieties in transparency. It also finds that the legitimacy of these funds should not be challenged because the political motivation does not necessarily change their market attributes. Although effective management of the funds requires improvement of transparency, the transparency standards should be moderate in the context of economic integration and financial globalization, hence international governance is a must. In addition to the reflection on the role of IFSWF in international governance, some lessons and*

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suggestions are given to China's SWFs at the end of the paper.

Key Words: *Sovereign Wealth Funds; Middle East; Transparency; China Investment Corporation*

I. Background

Sovereign wealth funds (SWFs) are state-owned investment funds set up to invest excess foreign exchange reserves or natural resource export surplus (IMF, 2008: February 29). Defining SWFs is a very hard, if not impossible, task due to their different nature and peculiarities. They represent a very heterogeneous group scattered all over the world (Turco, C., 2013: October). SWF became a hot keyword in the aftermath of the 2008 financial crisis, but in fact it is not a new investment vehicle. Since the first SWF was established in 1953, SWF has had a history of more than half a century. However, the SWFs are not capable of influencing political and economic stability and market competitiveness internationally until the latest financial crisis. The global scale of SWFs has nearly reached $7 trillion in 2015, which has doubled the amount at the end of 2007.[①] SWFs have become the world's most important non-traditional investment and management assets, with nearly 2.5 times the size of the global hedge fund and nearly 2.3 times the size of private equity fund (Bortolotti, B., 2013: September 5). According to the Sovereign Wealth Funds Institute (SWFI), there are 75 SWFs in the world, among which up to 48 have been newly established since 2000, and 20 since 2008. More surprisingly, SWFs in the Middle East and Asia dominion together accounted for 75% of the total scale of the world's SWFs. Noteworthy, in the Middle East, 12 countries out of 22 countries had set up 20 SWFs, and reached the size of $2.65 trillion, accounting for one third of the world's total scale.[②]

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① http://www.swfinstitute.org/.

② The 2014 Preqin Sovereign Wealth Funds Review.

The emerging SWFs in developing countries from the Middle East, China and Russia, have injected tremendous capital into recipient countries like the US, UK, France and other European countries during the disastrous global financial crisis, which were in critical need of liquidity, development and economic growth. However, SWFs are considered not only a savior of the world finance but also a possible threat due to their limited disclosure and a general lack of information on the topic at the international level. Suspicion and apprehension in recipient countries have been aroused for inadequate transparency of SWFs (Truman, E., 2007: October 19).

Transparency is a prerequisite for good governance and sound financial regulation. After doing a literature review on the transparency of SWFs, one can find that many SWFs avoid public disclosure of the assets size and strategies, and lack a coherent governance system in which the withdrawal and accumulation rules, investment management policy and reporting measures should be clearly defined. For some reasons, some perceive SWFs as a threat to liberal free-market capitalism with the potential of undercutting the functional efficiency of markets (Beck, R. & Fidora, M., 2008). Now, how to understand the role of SWFs, the government-owned investment institutions with a tremendous amount of assets under management with highly secretive operation systems, became a political debate.

There are concerns that these funds might have non-commercial objectives or might target at strategic assets in the host economies. This perception has fuelled resistance to SWF investments, particularly those thought to jeopardize the national security of their host sovereigns. Another concern is SWFs' potential distortion impact on the global financial market as their investment strategies are presumably designed by their sponsoring governments (Kimmit, R., 2008: February).

Following suspicion and apprehension, stringent regulations and restrictions in the name of protecting national security have been released or revised in the recipient countries to the foreign investment. Those measures raised concerns amongst the SWF s' sponsoring governments about potential unfair economic and political barriers and protectionism in those states. In order to mitigate the opacity of the SWFs and the hostility of the restriction, international organizations strive to formulate the best principles and practices for the funds.

Significant achievements have been made in the increase of SWF transparency thanks to the creation and adoption by SWFs of the 24 Santiago Principles, also known as the Generally Accepted Principles and Practice(GAPP), a set of principles that properly reflects SWF investment practices and objectives, drafted in Santiago de Chile in 2008 by the IMF and a group of 26 SWF sponsoring member states of the international working group (IWG). After the drafting of the Santiago Principles, the creation of the IFSWF in 2008, the voluntary group of SWFs that meet and exchange views on issues of common interest and facilitate an understanding of the Santiago Principles and of SWF activities, is an important evidence of this necessity to further develop SWF transparency.

II. The Issue of Transparency of SWFs

Transparency is closely related to market economy. A rational choice is regularly made to maximize one's profits when the decision maker can gather sufficient information about it. The amount of information gathered by market players mainly depends on the transparency of the market. So the transparency of the market has a crucial impact on the rational choice. Though there is no widely accepted definition of the transparency, the concept has been extensively analyzed in many disciplines, such as game theory, information theory and political economy (Mock, W., 2000: 293). It is a key issue associated with the dynamism in international political economy and there is a trend towards more transparency and regulation of the world economic system, especially in light of the global financial crisis. World Bank, IMF, G20 and other influential international organizations emphasize the great value of the transparency for the stability of international finance on various occasions.

Meanwhile, transparency is also a requirement when the bilateral or multilateral agreements are being negotiated, dispute settlements to be rendered, or international rules and regulations to be adopted. Lacking transparency, it will be illegal, or at least unfair and undemocratic (Mock, W., 2000: 293, 295; Lacarte, J., 2004: 683-686). In many international law studies, treaties and conventions, transparency plays a major role, and is regularly recognized as a key element in government reform (Schooner, S., 2002: 103, 105). It becomes one of the general principles of international governance to determine the legitimacy of an international institution (de Bellis, M., 2011: 349-382). In general, the SWFs should conform to the transparency principles required for good corporate governance as the other financial institutions do. However, there is no consensus on the requirements of transparency for SWFs all over the world. The standards of the concept have been hotly discussed in the international community in recent years.

2.1 The Definition of SWFs Transparency

The transparency of SWFs is generally defined as the level of information disclosure to the investors, the relevant administrative departments of the recipient country, stakeholders or the public in the operation of SWFs, concerning basic corporate information, management information, risk management and investment information.

The transparency of SWFs can be classified into two categories. The first one is the information and documents that SWFs are supposed to disclose to the public, shareholders and stakeholders. The second one is the transparency of the investment review by the recipient countries pertaining to the doctrine of equal treatment among the investors. The former, discussed in this article, features four types of relationships between 1) the SWF and the sponsor, namely the country or the government which owns the SWF; 2) the internal organizations and organs within the SWF; 3) the SWF and the recipient country, and; 4) the SWF and its stakeholders as well as the public. Only with the ample information being timely disclosed in the four types of relationship can the fund be considered transparent and responsible for the investors.

2.2 International Rules on Transparency of SWFs

Since the international community has not reached consensus on the international standard for the transparency, most of the SWFs have not consented to adopt an appropriate level of transparency. Great efforts have been made by the international community, the best example among which is the formation of GAPP, which proposes the requirements of the information disclosure of the SWFs and the obligation of "Publicly Disclosed" with 11 principles in three aspects, respectively, the source of SWFs funding and the legal framework, the corporate governance and the risk management.

2.2.1 The Source of SWFs Funding and Internal Structure

GAPP 4.1 Sub-principle stipulates that the source of SWF funding should be publicly disclosed. Legally, the source of SWF funding is connected to the ownership of the wealth and division of power and responsibility. The main source of SWF funding is financial surplus and foreign currency reserve which is classified as public savings. In this way, the various sources of SWF funding should be managed according to different laws and regulations. Thus, the public disclosure of SWFs enables the investors to have a better understanding of the responsibilities of SWFs.

GAPP 16 Principle requires that the governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed. As the managerial personnel of SWFs is very often composed of government officials of great political influence, and SWFs is seldom under the supervision of the domestic supervisory authorities, the clear and transparent sharing or allocation of the responsibility among the international departments within the SWF will facilitate the separation of the rights and obligations among internal departments and thus avoid the possible buck-passing. Besides, the public trust to SWFs will be enhanced in this manner to mitigate the domestic public pressure when the investment fails.

GAPP 1.2 Sub-principle requires that the key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other governmental or state bodies, should be publicly disclosed. The legal basis and structure will demonstrate the legal status of the investors, and ensure that the SWF’s transactions are lawful. Such public disclosure should contain information of the mandate to assets and investment. Thus the SWFs’ legal structure can strengthen the public’s understanding and confidence in the currency management authorization.

2.2.2 The Corporate Governance of SWFs

GAPP 2 Principle prescribes that the policy purpose of the SWF should be clearly defined and publicly disclosed. The appropriate policy purpose of the SWF lays the basis for the sound corporate governance and facilitates the formation of the purpose-oriented investment policy. GAPP 18.3 Sub-principle requires that a description of the investment policy of the SWF be publicly disclosed. As mentioned earlier, the investment policy serves the investment purpose, covering the fund’s preference of investment risk, the investment scope and the strategic asset allocation. Such professional administration will free SWF's investment from the influence of political purpose. GAPP prescribes that the SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy on economic and financial ground only. GAPP 19.1 Sub-principle also regulates that if investment decisions are subject to other factors than economic and financial ones, they should be clearly set out in the investment policy and be publicly disclosed. The reasons and factors for which some SWFs eliminate certain investment should be publicly disclosed if they are pertaining to the legally binding international sanctions or concerning social, environmental, moral or religious factors.

GAPP 21 Principle prescribes that the SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights. It requires that the SWF should publicly disclose how its voting right is exercised to protect SWF's financial interest. And the specific voting manner exercised by the board representatives should be publicly disclosed. The board representatives, if the SWF has one, should take the appropriate fiduciary duty for the board to safeguard all shareholders' interests. They can also disclose the appropriate information afterwards to manifest that SWF's voting decisions are invariably based on economic and financial standards.

2.2.3 The SWF's Risk Management

A credible risk management framework will contribute to the sound investment operation and accountability system. GAPP 22.2 Sub-principle prescribes that the general approach to the SWF's risk management framework should be publicly disclosed. Taking great political risks along with the traditional exchange rate risk and the investment risk, the SWF should publicly disclose the risk management framework to enable the administrators to have a systematic and overall analysis about the potential risks. It is favorable for the risk prevention and will obtain the massive credit and support from the citizens of the recipient country. The government, the sponsor of the SWF, often sets out the general risk limit on each investment or prohibits the SWF's investment in certain areas. For this reason, the asset allocation and financial statement should also be publicly disclosed. GAPP 4 Principle requires that there be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations. GAPP 17 Principle requires that relevant financial information regarding the SWF be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to the stability of international financial markets and enhance trust in recipient countries. All the information mentioned above will illustrate the fund's risk-taking capacity in regard to risk tolerance, liquidity and investment horizon.

The GAPP, a set of international standards newly established for SWFs, is merely voluntarily accepted by 30 members in the world. There are also different approaches to describing the transparency standards of SWFs. For example, some researchers have summarized the SWF's duties of public disclosure in five aspects, namely politics, procedure, policy, operation and performance on the basis of the approaches that the central bank is taking to the transparency (Dixon, A., 2014: 37; Dixon, A. & Monk, A., 2012: 275, 281; Geraats, P., 2002: 532). In the sections below, the SWFs in the region are examined and rated mainly according to the principles and standards required in GAPP.

III. The Need for a Greater Transparency of SWFs in the Middle East

3.1 Two Approaches to Evaluating the Transparency of SWFs

While the problem of transparency has already been addressed with the creation of the Santiago Principles and the methods for measuring transparency have been devised as well, such as the Linaburg-Maduell of the SWFI, the Worldwide Governance Indicators of Kaufmann, Kraay and Mastruzzi and the Truman-Dawson scoreboard of the Peterson Institute.

In this article, two indexes are cited to describe the transparency of SWFs in the region, namely the Truman Scoreboard and the Linaburg-Maduell Transparency Index (L-M Index). Both methods introduce an index for transparency of each fund, and these indexes are calculated from a series of yes /no questions. The sum of the scores for all the answers about each fund represents the index for transparency of that fund.

In 2007, Edwin Truman from the Peterson Institute for International Economics created a scoreboard for SWFs, with ranking on the funds based on systematic and regularly available public information. The boards measure the funds in four areas, 1) structure, 2) governance 3) transparency and accountability, and, 4) behavior. Within each category there is a set of yes or no questions, the answers to which score 1, 0.5, 0.25 and 0. By using this Scoreboard Truman has tested most of the SWFs in the world, ranking them as High, Moderate, and Low rating from 0-100. According to this approach, the majority of the funds in the developing countries are listed in the Low group with exceptional cases like Temasek of Singapore.

The L-M Index was developed by Carl Linaburg and Michael Maduell at the SWFI. This index of rating transparency was developed in 2008 and has since been used worldwide by global sovereign wealth funds in their official annual reports and statements. This index is based on ten essential principles that depict sovereign wealth fund transparency to the public. Each principle adds one point of transparency to the index rating. The minimum rating a fund can receive is 1. However, the SWFI recommends a minimum rating of 8 in order to claim adequate transparency. [①]

3.2 The Scores and Ranking of the Funds

According to the study and measurement mentioned above, the majority of SWFs are lacking transparency and good governance and the 2014 GeoEconomica Report emphasized the poor performance in information disclosure of the Middle East SWFs.

Since 2008, SWFI has measured quarterly most of the SWFs with the L-M Index and the ranking of more than 50 major SWFs are released on its website. According to this Index, a SWF should be rated above 8 in order to be adequately transparent. However, half of the SWFs are below 8. In case of the release in the second quarter of 2015, 29 SWFs are below 8, in which China Investment Corporation (CIC)[②] has scored 8. The ratings of counterparts in the Middle East are not satisfactory. Only 3 SWFs in the region get an 8+ score and 11 SWFs are below 8, among which 6 SWFs are less than 4 (See Table 1).

According to the scores given by Truman in 2010 which measured 53 SWFs in 37 countries, the Norway Sovereign Wealth Fund (GPFG) got the highest score-- 100 points, while Sudan Oil

① Principles of the Linaburg-Maduell Transparency Index cover ten aspects information disclosure, see: http://www.swfinstitute.org/swf-research/linaburg-maduell- transparency-index-released/

② China Investment Corporation was established in 2007 as a major SWF in China with a first allocation of 200 billion, though sometimes China-SAFE or the China-NCSSF are also considered as SWFs. However, CIC is the only one chosen in this paper as the typical SWF standing for the SWFs in China.

Revenue Stabilization Fund got 2 points, the lowest. The average score of the world is 57 points which were surpassed by 14 funds. In 2013 Truman released the second scoreboard with similar outcome, in which 49 SWFs were measured with an average score of 54 for the SWFs globally. But Truman emphasized the improvement of transparency made by the 26 members of IFSWF with an average score of 65, higher than the world's average. In that report, several SWFs have been mentioned for their effort to enhance the transparency of the funds in a couple of years. SWFs from Iran, United Arab Emirates and Qatar are among them.

In fact, the transparency of the Middle East Fund does not call for optimism. Among 10 funds listed in this scoreboard, only one fund is above average, the Mubadala Investment Company from United Arab Emirates scored 68, and the others are lower than the average, scoring from 2 to 48. Compared with the transparency of the global SWFs, the vast majority of the Middle East falls in the low classification. See Table 1.

Table 1: Transparency Scores of the SWFs in 2010, 2012 and 2014 [1]

No.	nation	SWFs	L-M Index		Truman	
			2014	2010	2010	2012
1.	UEA	ADIA	6	4	4	58
2.	UEA	IPIC	9	3	21	46
3.	UEA	Mubadala	10	10	68	65
4.	UEA	Dubai	n/a	n/a	36	55
5.	UEA	ICD	5	4	21	21
6.	UEA	EIA	3	2	n/a	n/a

[1] The 2014 Preqin Sovereign Wealth Funds Review; SWF Institute website; Truman, Sovereign Wealth Funds Threat or Salvation, 2010,pp.72-73 and Truman, Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard,2013.

7.	UEA	RAK	n/a	n/a	n/a	n/a
8.	Iran	IRAN State	5	1	18	41
9.	Saudi	SAMA	4	4	n/a	n/a
10.	Saudi	PIF	4	4	n/a	n/a
11.	Kuwait	KIA	6	6	48	73
12.	Libya	LIA	4	2	n/a	6
13.	Qatar	QIA	5	5	2	17
14.	Bahrain	Mumtalakat	9	8	43	39
15.	Oman	SGRF	4	1	18	27
16.	Oman	OIF	4	1	n/a	n/a
17.	Iraq	IDF	n/a	n/a	n/a	n/a
18.	Palestin	BIF	n/a	n/a	n/a	n/a
19.	China	CIC	8	7	61	64

3.3 The Improvement

In addition to the low level of transparency, those studies have also shown that transparency has been significantly improved in the recent years. In the L-M Index, the average transparency score of 14 funds in this region increased 1.4 points, from the 3.9 points in 2010 to 5.5 points in 2010. As the individual fund in the five years, IPIC's scores increased from the original 3 to 9 points, Iran and Oman funds have increased from the original 1 to 5 and 4 respectively. Consequently a total of nine funds have different rate of increases. See Figure 1.

While the transparency requirement for the SWFs has triggered a hot political debate and resulted in more restrictive investment measures in host countries, most SWFs in the region, as active outward investment vehicles to upgrade the profit return rate and reduce investment risks, have made significant progress in transparency.

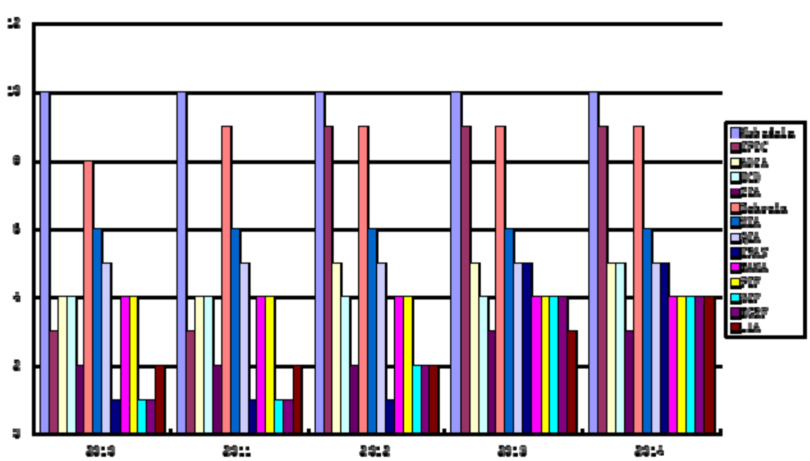
The 2012 Truman's scoreboard has also found that many SWFs, in particular funds associated with the IFSWF, have made substantial progress responding to demands at home and abroad for greater transparency and accountability about their activities. This study shows that the IFSWF appears to have been broadly, but not universally, successful in raising global standards of transparency and accountability of SWFs.

IV. Contribution by IFSWF Accounting for the Improvement

The progress achieved by the SWFs in the region partly, if not mostly, derived from the efforts taken by international institutions, driven mainly by the establishment of IFSWF as a global network of SWFs.

Policy interests and concerns towards SWFs surfaced at a multi-governance level in the later part of 2007 when SWFs had become well-known to governments and the financial world for their active engagement in the international capital market and the quarter consisting of funds from China, Russia and the Middle East Gulf Region, either in number or size, had substantially increased since the end of the 20th century. Subject to the G7 Finance Ministers' guidance and the IMFC's direction, the IMF convened a roundtable of sovereign assets and reserve managers from 28 countries. Issues "include[d] matters of transparency, accountability and governance" (IMF, 2008: February 29) resulting in the creation of the Santiago Principles, a set of 24 voluntary guidelines that assign "best practices" for the operations of SWFs through a joint effort between the IMF and the IWG. Then the SWFs embraced the IFSWF. This inclusive body, open to all SWFs agreeing to accept and foster those Principles, is trusted to be the administration for the Santiago Principles, promoting "an innovative, post modern approach to global governance."[1] The forum is underpinned by a system of "peer review" to which SWFs members have committed themselves. The fruitful outcome of this system is represented in the reports on the International IFSWF Members' Experiences in the Application of the Santiago Principles, which are surveys conducted and published by IFSWF with the assistance of its members. The Report in 2013 concluded that "it is positive to note that more members have responded and more members fully implemented the Santiago Principles in 2013 compared to 76% in 2011" (IFSWF, 2013: October 2-3). By examining the detailed comparison between 2011 and 2013 respectively and accordingly it is revealed that improvement of the member funds in transparency are quite substantial compared with the non-member counterparts, as shown in Table 2. This conclusion is consistent with the improvement of transparency of the SWFs in the region as discussed in Part 3 of this article. The international governance in which IFSWF is a major contributor should be addressed for the upgrading in transparency of the

Figure 1: Improvement of the transparency Indexes from 2010-2014 (Sovereign Wealth Fund Institute, 2015**)**



[1] http://iwgswf.org/pr/swfpr0901.htm.

funds, because the majority of the funds which have improved their performance in disclosure are members of IFSWF, except Oman. IFSWF brought together nearly 30 SWFs members including many funds in this region from the United Arab Emirates, Bahrain, Iran, Kuwait, Libya and Qatar.

Table 2: Response Comparisons between 2011 and 2013 ①

	Fully implemented members to all response members		Partially implemented members to all response members	
	2013	2011	2013	2011
GAPP1 Legal structure	95	95	5	5
GAPP2 Policy purpose	95	95	5	5
GAPP4 Funding	95	89	5	11
GAPP6 Governance	90	95	10	5
GAPP11 Annual Reports	95	94	5	5
GAPP15 Compliance of the disclosure regulation	90	88	10	12
GAPP19 Investment policy	95	93	5	7
GAPP23 Performance Report	90	83	10	17

V. Causes for Opacity of SWFs in the Middle East

The variety of SWFs, in terms of motives and objectives of the establishment, the investment policies and strategy taken by the SWFs together with other factors, will impact SWFs' decision on how much and how often the information is to be disclosed. And the preference emerging in the 21st century to portfolio investment for SWFs contributes to great difficulty in tracking their

① http://www.ifswf.org/pst/Oslo2013/2013ifswfreport.pdf.

investment activities, which decreasing the willingness of SWFs to be transparent. Besides the general consideration for commercial operations, the social-political environment, business cultures and management of SWFs in the region should also account for the opacity of its SWFs.

5.1 **The Unbalanced and Diversified Political-economic Development in the Middle East**

Their societies are now generally undergoing transformation (Jiang, Y., 2011). The general economy in the contemporary Middle East, according to the World Bank's Classification Standard, has reached the level of low-and-middle-income countries. Though some oil-producing countries in the Gulf now become affluent, their market economy is still in infancy as their wealth accumulation is based on oil business. Generally speaking, societies of market economy are requiring a highly transparent-and-efficient market environment due to the need of the public and private sectors' development. But the Middle East countries are not doing well in this aspect. Blood-and-geography-formed tribes are the most stable social structure in Middle Eastern social organizations, which is especially true in this region's oil-producing countries of dominating monarchy (Huang, M., 2007: July).

5.2 The Governance Capacity and Social Corruption

Low transparency is usually related to corruption, deficiency of governance capacity and lack of competitive power. According to *Corruption Perceptions Index 2013* released by Transparency International, among the 177 countries and regions under investigation, only Qatar and United Arab Emirates in the Middle East countries were ranked among the first 30; other countries in the Gulf Cooperation Council and Arab countries (such as Jordan) were all of the median-level, ranked around 60. Iran was ranked

144, Syria 168, Iraq 171, and Libya 172 (at the bottom of the Index).[1] The Index shows that corruption in the Middle East exists both in low-income (such as Iraq and Yemen) and in high-income (such as Saudi Arabia and Kuwait) countries, resulting in low transparency.

5.3 The Arabian Culture and its Unique Management Mode

The business cultures in the Middle East are deeply affected by Arab-Islamic culture. For the heterogenic-culture-repulsing gene inherent in Islamic Culture, and the humiliating history of colonization by Western intruders, the Middle East countries may have developed a resistant tendency towards Western culture and its modernization model. Not totally accepting the set of rules about Free Market advocated by Western developed countries, those countries adopt a government-intervention mode for economy, and seldom enact special laws or regulations on information disclosure for financial institutions as advanced market countries have.

The unique management mode in this region (not including a handful of countries) is also due to lack of transparency. With low or even no pressure of public accountability and no need to attract investors for the oil economies ruled by kings or royal families, many private and government enterprises in the region are not obligated to disclose their dealing details, business documents or annual reports. The funds' senior management in these countries are usually monopolized or controlled by the royal families, thus the governments are exerting influence on these funds. For example, ADIA, with the world's largest asset inventory, is under the charge of Sheikh Abdullah who comes from a royal family. GCC countries' SWFs, whose capital sources come from oil-producing and export income, are founded directly by the king,

[1] http://www.transparency.org/cpi2013.

the royal family or the government representing the king. They receive no supervision from the third party or the public and have no disclosure obligation. What's more, the managerial structures of the businesses in this region are of huge complexity that also leads to its inconceivability to the outside world (Jiang, Y., 2011).

VI. Reflection on the International Governance of SWFs

The primary reason for questioning the opacity of SWFs, apart from consideration of the market risks, is the apprehension that such state-owned funds would become geopolitical tools manipulated by the host state which has a complex interaction with these funds. Developed countries expect SWFs in the world to operate under required norms and regulations. However, if it is to give retrospection on the development of transparency principles and an analysis of causes of Middle East SWFs' murkiness, the understanding could be obtained that the transparency standards is bound to be moderate due to the diversified political-economic development and business cultures in different countries. Consequently, the legality of these funds should not be questioned even though their opacity has elicited Western countries' dissatisfaction; additional investment restrictions or requirement should not be forced on SWFs as the political motives of SWFs exert no influence on their market properties. International cooperation and institutional mechanism should be the reliable source to build up a set of unified regulations for SWFs transparency.

6.1 A Moderate Standard due to the Diversified Transparency Situations in Different Countries

Different countries have varied political value orientations and their acceptance levels towards economic opening and transparency are also varied. This is especially true in the region. With different founding time, capital scale and investment objectives etc., SWFs in each country possess diverse asset values, and their investment strategy, asset portfolio, corporate governance structure, risk management system, enterprise culture and interior accountability system are all diversified, resulting in differences of their disclosure extent. The SWFs of different mandates are expected to have varied disclosure standards consistent with their short-term or long-term investment. Thus, despite the existence of some highly transparent funds, there are funds that seldom disclose their asset structure, investment strategy, etc. as a result of their many strategic investments or law restrictions.

However, according to the Financial Risk Management studies and Corporate Governance Theories, the main methods to deal with the information asymmetry and protect investor interests are to improve the transparency of financial institutions and to found a rigorous information disclosure system. Therefore, SWFs are obligated to assess their transparency and establish a refined disclosure system. On the other hand, with non-domestic investment objectives for most SWFs, their overseas investments are facing more restrictions, one of which is the transparency requirement from the recipient countries. From the perspectives of both market requirement and efficient management, SWFs, represented by those in the Middle East, are in need of improving their transparency; hence the international efforts in formulating the relevant unified regulations. But such regulations should show moderation, and not impose more rigorous requirements than those on other institutional investors in the international financial market, such as internationally active banks, hedge funds or private equity firms. To impose additional requirements on SWFs because of their special nature of ownership is unjustified, for it is against the principles of market economy and will face difficulties for enforcement.

6.2 Legitimacy of SWFs with Low Transparency

It is mainly because of the SWFs' political nature that leads to the questioning of transparency by the Western countries. The connection between politics and market, in the eyes of most Western developed countries, is incompatible with Free Market; some skeptics hold that state-owned business entities, even when possessing high autonomy in enterprise organization and operating decisions, are still targeting at serving their political interests through the Free Market. The government is exerting limited influence only on private-owned enterprises; the state-owned business is another case. Business entities like SWFs are considered as violating market principles and a threat by those developed countries who think special restrictions upon these funds, one of which is transparency requirement, are necessary.

Yet the political motives have not changed the SWFs' market properties, for market itself also has political attribute. The capitalist development in the past 150 years shows that the government has always been supporting the capitalism market development. Through legislation, the government has formulated rules for the market and provided public products for the market operation of the whole economic system. All successful market economies have powerful state management, for instance, when the market failure occurred in the 2008 financial crises, the government intervened to rescue the Free Market with its visible hands.

The government, with its ever existent support for Free Market, has had to intervene with its economy. SWF is not an enemy of the market but a kind of effective combination of the market and the state. More and more SWFs have been established in emerging countries after the national liberation movements in those countries and the Cold War. It is an indication that market economy has been accepted and integrated in those economies, other than a resolution or result of imbalance of international payments or over-high commodity prices in developing countries. Middle East countries, of diverse political and economical situations, have in the past decades founded their own SWFs which kept pursuing the maximization of capital gain in the international financial market. The successful development of these funds has proved that the market economy has been chosen and supported by these countries or governments.

Furthermore, transparency of the SWF is no guarantee for purely economic motives, or in other words, it has no logical relation with the investment intention. A classic example is Norway's Government Global Pension Fund, which ranked top in both of the two transparency indexes mentioned above. Its investment decisions are not made solely on the basis of the economic and market factors, but also non-economic factors, such as human rights and environmental issues. To conclude with some researchers' comments, "transparency extent is not the best scale for measuring the SWF's objectives," and "it is wrong to judge purely economic motives through the transparency". Therefore "we cannot delimitate between the good and bad funds only by their transparency level."

6.3 International Mechanism for Moderate Transparency Standards

With the global expansion of the SWFs and their risk taking preference, the funds as a whole play a more and more active role in the global capital market. For risk management and stability of the global financial system, proper supervision is necessary for these funds. Currently, the transnational supervision for SWFs mainly comes from host country. Many countries have carried out or revised the national security review methods and policies, which, as can be seen from the latest legislative practice in the world, have become a guise to restrain SWFs' overseas investments. This kind of investment review, usually out of political rather than economic consideration, can easily turn to abuse. "Politics has become essential when America is formulating foreign trade policy" as some critics commented on American investment laws. But economic isolationism will be a thing of the past. And developed countries, as advocator and beneficiary of investment liberalization, will not always resort to investment restrictions under pressure of domestic political conflicts or economic cycle, for in the contrary case, economic protectionism would prevail and hurt the national interest.

Still, to improve the SWFs' transparency is critical to the sustainable development of SWFs. On the one hand, there is constant striving in financial industry for higher transparency to stabilize the financial system and to resist the systematic risks. In recent years, financial regulators in many countries have been raising the disclosure standard on banks and other financial institutions such as hedge fund. One of these efforts is the European Union's *Alternative Investment Financial Managers Directives*. On the other hand, large companies in the developing countries will be more internationalized, profoundly integrated in the developed economies. The convergence of transparency standards will prevent domestic companies from unwanted restrictions in their internationalization process. Transparency improvement of domestic SWFs will avoid collision with the investment barriers in overseas merger and acquisition. Hence there is the necessity of cooperation between newly-developing countries and developed countries.

In a fragile international financial system, the tendency of economic integration and financial globalization makes it necessary to enhance the policy coordination among all countries. Any economic problem or policy choice in the inter-dependent economic world is under profound “international influence” and should be viewed as global public problem rather than merely one country’s issue. This applies to SWFs transparency problem. The founding of international mechanism (bilateral, multilateral and regional), as many international economic-political studies have revealed, will be able to resolve the economic and trade disputes caused by domestic political conflicts, and a good international regime will bring about resolutions of the global issues. The drafting of the Santiago Principles is an encouraging evidence for the statement.

6.4 The Role of IFSWF in the International Governance for SWFs

Currently the Santiago Principles are the primary and widely accepted international standards regulating SWFs. As a set of voluntary regulations with certain ambiguous rules and lack of administrative agency, GAPP is questioned about its design and efficiency when it was formed. However, created as a public good the international mechanism can facilitate cooperation between actors, by imposing restraints on actors and reducing the costs of legal trades as well as increasing that of illegal trades. As Keohane said, “even though this regulatory system is inconsistent with the self-interest of some governments, they will still conform to it after weighing the reform difficulty and a series of uncertainties.” The creation and efforts of IFSWF resulting in the members’ improvement on compliance, especially the contribution given to transparency improvement of the SWFs in the region as analyzed above, are support for the statement of Keohane. So it is justified in believing that IFSWF-based international governance will be the efficient method for SWFs transparency improvement. And the 6-year international practice since IFSWF's foundation has proved this belief. The 2013 Report showed that there was constant increase of members who are willing to participate in this type of assessment and that compliance with the regulations is also improving. Now Santiago Principles have become the guidelines for the major SWFs' overseas investment. And an increasing number of newly-developing countries, as shown in the 2013 Report, have stressed the significance of compliance to GAPP: most of the above mentioned Middle East Countries, which gained noticeable improvement in transparency scores, are members of this organization.

VII. Lessons and Suggestions to China on Transparency Improvement

China Investment Corporation (CIC) is a major SWF in China, whose transparency is at the world average level. An analysis of the Middle East SWFs' transparency development can provide several lessons and suggestions to China.

7.1 For a better running and efficient management in the international market, transparency improvement of CIC is necessary. This can gain international community's understanding and trust. CIC needs to moderately improve its transparency without hurting business opportunities. And as an important member of IFSWF, CIC should make more efforts improving the information disclosure according to the GAPP regulations.

7.2 Established in just a couple of years, GAPP's operability and influence can be expected to improve in order to be adopted by more states. In this situation, CIC with its large scale should play a more significant role in this international forum, and make contribution to GAPP for its legitimacy and influence enhancement by actively participating in agenda design on transparency issues within the Forum and provide China's version of transparency standards, because these design activities will have impact on CIC's information disclosure and its vital interests. Nevertheless, to give more voice in constructing the international regulatory system of SWF transparency, CIC should first do a planning on its own transparency regulations.

7.3 The sign of transparency improvement is adequate and timely disclosure, and the preferred media of disclosure is website. The websites of SWFs in the region which present an above-average transparency all have a well-rounded development. Elements of these websites usually include the framework and structures of the funds, such as the legal framework, visions and general principles of the fund, its macroeconomic linkage, objectives and motives of establishment, the structuring and operating rules of main organizations like board of directors; the asset information like asset scale, asset portfolio and regional distribution of investment; investing management like investment policy and strategy, fundamental policies and procedures in the managerial decisions; the performance information like the annual report; and other information like the latest news release of the fund. CIC should make the best of website disclosure to moderate the outside suspicions.

SWFs in countries like United Arab of Emirates, Qatar and Iran have a significant transparency improvement in the last 5 years, which was achieved by their adequate release of political and procedural information while keeping a moderate disclosure of some aspects of their operations. Drawing lessons from this, CIC is expected to have a further disclosure of its capital source, making clear explanation of the means of gaining capital through issuing special national debts and replacement of the foreign exchange reserves; of its relationship with the government, the Ministry of Finance and the Central Bank; of the investment decision-making procedures, namely what kind of procedure is required in each investment decision; of the responsible bodies for investment profit and loss, and of the accountability system. And according to China's Company Law, CIC, a solely state-owned LLC, should expound on its administrative structure, including board of directors, party committee, international advisory committee, and clarify the functional division of CIC, Central Huijin Investment and the international investment corporation. This will sweep away much confusion from the market. As a matter of fact, disclosure of these aspects will not affect business opportunities, and a highly transparent administrative structure can boost outside trust and reduce external pressure.

However, for most of the Middle East SWFs, disclosure of operation and performance of the portfolio investments is limited. Thus CIC's disclosure of this information, considering its founding objectives and investment strategies, may also be kept at a moderate level. Yet a focus for CIC is to enhance the publicity for policy and strategy on its investments. It should further explanation that its objective is a long-term profit maximization; the long-term investments are driven by business purpose and with no stock-holding intent it will not add risk to the global financial market.

CIC has recently released some fund news on the official website and disclosed its 2013 and 2014 annual reports. But these annual reports, compared with that of KIA and IPIC, seem to be brief with incomprehensive and time-lagging information. Thus it is expected to add cash flow statement in the report with independent audit report for credibility. Disclosure of the risks CIC confronted and its management methods, like the selection process of fund managers and salary system, should also be quantified. Such disclosure will enhance trust from domestic citizens and prevent the opinion pressure. However, discretion and moderation are necessary in the transparency improvement for portfolio investments. Equity investment in the primary market can be disclosed with less reservation because it is no secret to the outside world. For example, CIC's investment in the stock of various public companies like Blackstone and Morgan Stanley will be announced by invested companies. On the other hand, SWFs are reluctant to disclose the asset composition for investments in the second market, because the disclosure will reveal their investing strategies to other companies and thus "sell into corrections" would occur to them. In this case, to establish some guiding principles as KIA did will help win understanding from the outside.

VIII. Conclusion

Even though it is reasonable for western countries to express dissatisfaction towards the inadequate transparency of SWFs, the legitimate questioning of SWFs, whose transparency is especially low in the region, is not justified. As their political motives will not change their market attributes, there is no need to impose special requirement upon SWFs. With retrospection on the transparency standards development and an analysis of opacity causes concerning the Middle East SWFs, we could understand that the transparency standards are bound to be moderate due to the diversity of political-economical developments, government accountability and enterprise cultures in different countries. The transparency improvement is necessary for efficient management of SWFs. A reliable approach to achieving this will be the IFSWF-based international mechanism. As mentioned above, most of the Middle East SWFs which received noticeable improvements in transparency scores are members of IFSWF, and an increasing number of emerging countries have stressed the compliance with GAPP. Actually, the Principles have already become the guidelines for the major SWFs' overseas investment (IFSWF, 2013: October 2-3).

The transparency improvement of the SWFs in the Middle East is valuable experience for China. For a better operation and efficient management in the international market, CIC's transparency improvement is necessary. Under prevailing requirements from the international community, CIC needs to moderately improve its transparency without hurting business opportunities. Some SWFs in the region have significantly improved their transparency in recent years, which sets a good example for China's SWFs to follow. While as an important member of IFSWF, CIC should also enhance its efforts for international governance of transparency according to GAPP regulations. It should actively participate in agenda designing within this Forum and provide China's version of transparency standards, for these activities will have great impact on its information disclosure and vital interests.

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