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Sovereign Wealth Funds and National Security- Three Purposes of Regulations And Beyond

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Abstract:
In light of the fact that the international investments made by state investors have tremendously expanded since the 19th century, there is a heated debate concerning the regulatory issues and challenges raised by sovereign wealth funds ('SWFs'). This paper seeks to identify the obscure purposes regulating SWFs. It provides an alternative perspective of national security through its impact of autonomy, disclosure requirement, and continuous development of International Law from the investor-state made to the host-state. It is illustrated through comparative studies of the SWF related rules of the United Kingdom, the United States and the European Union, where most of these SWFs from around the world are established. This paper hopes to raise these three questions for further research and provide a new angle to understand national security beyond the ordinary sense of physical harm but on top of its how its citizen's property is being protected and could not be deprived. This deprivation is different in the sense that the control is taken over through the operation of contracts and treaties, which are totally legitimate but could not be regarded as an integrity channel because of the potential political influence behind, its ability to be used for political purposes and interfere investment decisions if it contradicts with government interest. Even if these are not the intention to invest through SWFs, it could impose an invisible hand that creates fear of SWFs as there is a channel for economic retaliation or other forms of support that endanger national security. We believe the international legal community should expand existing rules and regulations to protect country autonomy, the confined scope for disclosure and reduce public worries over national security through promoting financial and economic national security.

Introduction

Since the 19th century, the international investments made by state investors have tremendously expanded through the establishment of Sovereign Wealth Funds ('SWFs'). SWFs are mainly created by oil-rich countries or have an excess of currency or BoP. The national governments establish it as a way to protect and stabilise their economies, earn extra returns and increase savings for their future generation.[1] Therefore, throughout the past few years, SWFs have given rise to a heated debate about regulatory issues and challenges in safeguarding national security due to such special roles to both the country who created SWF ('investor-state') and country which accepts investment from SWFs ('host-state'). The chief purpose of this paper is to examine the role of regulating SWFs in safeguarding national

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[1] Felix I. Lessambo, *International Finance: New Players and Global Markets* (Palgrave Macmillan, Cham 2021) 139-155.

security through identifying three goals of SWFs regulation which has not previously been made apparent. We illustrate relevant provisions from the United Kingdom ('UK'), the United States ('US') and the European Union ('EU'). Such purposes were not often explicitly addressed in regulations, and this paper concludes with some suggestions to reform of the existing regulatory framework to address these concerns.

The proliferation of international investments made by state investors has raised fresh concerns for national security not in the sense of physical invasion through weapons, but instead through an otherwise legitimate channel to interfere with the country's discretion to produce and trade as other countries become the new owner; in other words, it is tantamount to a monetary invasion. Such investments are often welcomed in the first place but once the impact becomes apparent, the host-state receiving the funds could start to feel the threat from the investor-state providing the funds. This monetary invasion often happens gradually and once it is discovered, it may be too late to reverse due to over-reliance.

This paper hopes to present this different perspective of national security by examining its impact on (a) autonomy, (b) the disclosure requirement, and (c) continuous development of international law from the investor-state made to the host-state; through illustrating the SWF related rules of US, the UK and the EU where most of these SWF from around the world are established.

What Is Sovereign Wealth Fund?

SWF is an investment vehicle controlled and created by state control entities ('SCEs') (also known as sovereign political entities), which invest intangible and financial assets. SWFs are also used to manage a portion of the national reserve. There is no universal definition for SWFs. Different institutions, international organisations, government agencies and scholars,[2] have provided different explanations for SWFs. However, most observers mutually agreed upon three main characteristics shared among SWFs.[3] Firstly, SWFs are state-owned, which is owned by SCEs. Secondly, SWFs are managed separately from those official national reserves. Thirdly, SWFs are involved in overseas investments. Truman suggested that government funds (i.e., governmental pension funds and subnational government unit funds) should be included in the definition of SWFs.[4] However, these funds are less likely to be invested for political purposes because of the risk of lower returns.[5] SWFs have three purposes: first, SWFs raise the rate of return for sovereign foreign exchange holdings; second, they stabilise the national economy; third, SWFs can generate more profit for the future generation. For example, Kuwait's SWF, which was found in 1953, was designed to provide profit for citizens once the emirates' oil runs dry. See the table below for main SWFs in the US, UK and EU. From the Table, the value of SWF has a significant portion of the country's GDP, ranging from 26% (China, which is at its start of investing through SWF via initiatives such as one-belt one road)

[2] Manda Shemirani, *Sovereign Wealth Funds and International Political Economy* (Ashgate 2010) 1 (hereafter Shemirani); Anthony Elson, 'Sovereign Wealth Funds and The International Monetary System' (2008) 9 (2) The Whitehead Journal of Diplomacy and International Relations 71; and Lixia Loh, *Sovereign Wealth Funds: States Buying the World* (Global Professional Publishing 2010).

[3] See Shemirani (n 2); Sofia A Johan, April Knill, and Nathan Mauck, 'Determinants of sovereign wealth fund investment in private equity vs public equity' (2013) 44 Journal of International Business Studies 155.

[4] Edwin Truman, *Four Myths about Sovereign Wealth Funds* (*Voxeu.org*, 14 August 2008) <http://www.voxeu.org/article/sovereign-wealth-funds-debunking-four-popular-myths> accessed 16 January 2022.

[5] It implies that there is a fouth shared characteristic, namely politically-driven investing.

to 557% (Kuwait, with the most extended history of the SWF investment) from selected countries. It indicates that SWF is a crucial investment tool for a country to invest in its surplus. It is an important engine to support economic growth through generating passive income. It also allows a country to participate in production which would otherwise not be possible to achieve independently. Table 1 shows the selected SWFs established in the US, UK, and EU. The total value of SWF ranges from 1.5 years to 5.5 years of their estimated GDP. For example, in Kuwait, the value of one of its SWFs could already support 5-year of economic production. It illustrates the strategic importance of SWFs in securing future economic development against adversities that disturb normal productivity. Note that SWFs are usually established in foreign jurisdictions, for example the Government Pension Fund Global from Norway is established in the US and the UK. The governance policy towards SWF regulation and political stability and attitudes of these countries would have rendered the stability of the SWF uncertain. All these would affect the ability of SWFs to safeguard the investor-state against any downside.

Table 1: Selected SWF established in the US, UK and EU (Including France, Italy, Spain, Switzerland) and Its Originating Country

Fund Name	Established in	Investor-state	Total Value (As of January 2022)	Estimate GDP 2021	Years of GDP (Total Value / Estimated GDP)
Government Pension Fund Global	US and UK	Norway	US$ 1,339 Billion	US$ 445 Billion	3 years
Government of Singapore Investment Corporation	US and UK	Singapore	US$ 578 Billion	US$ 379 Billion	1.5 years
China Investment Corporation	US	China	US$ 1,222 Billion	US$ 16,862 Billion	1.9 years
People's Bank of China	UK	China	US$3.21 Trillion		
Libyan Investment Authority	US	Libya	US$ 67 Billion	USD 27 Billion	2.5 years
Investment Corporation of Dubai	UK	Dubai (UAE)	US$302 Billion	USD 410 Billion	2.5 years
Abu Dhabi Investment Authority	Italy and Spain	Abu Dhabi (UAE)	US$697 Billion		
Qatar Investment Authority	France	Qatar	US$366 Billion	USD 169 Billion	2.2 years
Kuwait Investment Authority	Turkey	Kuwait	US$ $737 Billion	USD 132 Billion	5.6 years

Sources: International Monetary Fund, [6] and Sovereign Wealth Fund Institute.[7]

Three Purposes of Regulations Relating to Sovereign Wealth Fund

Whilst SWF continues to seek investment outside, corporates from the host-state also hope to attract funds. Yet, one must bear in mind the possible commitments made to the public of which the host-state may be unaware. Through our analysis of the SWF related law and regulations from the US, UK and EU, we have identified that three major commitments could lead to a potential threat to the national security of the host state in the eyes of the public, which has limited information to the actual operation and governance of these funds. These commitments could be summarised in three-folded:

1. The loss of host-state autonomy.
2. The duty to disclose material information to the public.
3. The continuous development of international law which goes beyond a shareholder's common role.

The contextual analysis conducted in this paper showed that the implicit operation of SWFs worked to mitigate the impact of these commitments.

A. Loss of Autonomy

The issue of autonomy emerges with state capitalism arising from the increased governmental involvement in the capital markets, especially from the US, UK, and the EU. The states feature it extended involvement and hence the influence on production and capital.[8] Autonomy is both visible and invisible, which refers to the autonomy of the companies in which SWFs invest. The visible hand lies on duty to investors, which is usually reflected in SWF documentation and disclosure requirements. The invisible side concerns whether corporates accepting sovereign funds would exercise their discretion to make decisions. The loss of autonomy rests mainly on the latter one, where they must report and act according to the will of the investors, who are essentially the project owners. The level of intervention is difficult to assess because SWFs do not operate in the form of state-owned enterprises ('SOEs') or SCEs. Moreover, the management and organisation of SOEs follow a capitalist model. The Indonesian Sovergen

[6] International Monetary Fund, 'IMF Data' (International Monetary Fund, 2022) <https://www.imf.org/en/Data> accessed 21 January 2022.

[7] Sovereign Wealth Fund Institute, 'Kuwait Investment Authority' (*Sovereign Wealth Fund Institute*, 2022) <http://www.swfinstitute.org/swfs/kuwait-investment-authority/ > accessed 16 January 2022; Sovereign Wealth Fund Institute, 'Libyan Authority' (*Sovereign Wealth Fund Institute*, 2022) <http://www.swfinstitute.org/swfs/libyan-investment-authority/> accessed 16 January 2022; Sovereign Wealth Fund Institute, 'Norway Government Pension Fund Global' (*Sovereign Wealth Fund Institute*, 2022) <http://www.swfinstitute.org/swfs/norway-government-pension-fund-global/> accessed 16 January 2022; Sovereign Wealth Fund Institute, 'Government of Singapore Investment Corporation' (*Sovereign Wealth Fund Institute*, 2022) <https://www.swfinstitute.org/profile/598cdaa50124e9fd2d05b242> accessed 16 January 2022; Sovereign Wealth Fund Institute, 'Abu Dhabi Investment Authority' (*Sovereign Wealth Fund Institute*, 2022) < http://www.swfinstitute.org/swfs/abu-dhabi-investment-authority/> accessed 16 January 2022; Sovereign Wealth Fund Institute, 'China Investment Corporation' (*Sovereign Wealth Fund Institute*, 2022) <http://www.swfinstitute.org/swfs/china-investment-corporation/> accessed 16 January 2022; Sovereign Wealth Fund Institute, 'Qatar Investment Authority' (*Sovereign Wealth Fund Institute*, 2022) <https://www.swfinstitute.org/profile/598cdaa60124e9fd2d05bc5a> accessed 16 January 2022; and Sovereign Wealth Fund Institute, 'Investment Corporation of Dubai' (*Sovereign Wealth Fund Institute*, 2022) <https://www.swfinstitute.org/profile/598cdaa50124e9fd2d05b49f> accessed 16 January 2022.

[8] Geoffrey Ingham, *Capitalism: With a New Postscript on the Financial Crisis and Its Aftermath* (Polity 2013) 56.

Wealth Fund ('ISWF') is a good example of integrating institutional corporate governance functions into SWFs by establishing two boards, namely the Supervisory Board and the Board of Directors. When comparing the corporate governance between ISWF and Limited company in Indonesia, observed there are only two laws and one corporate governance manual to guide the two Boards, which is not sufficient. For example, there is no regulation to handle shared ownership and transfer of company's assets.[9] It shows that the loss of autonomy could have arisen not only in terms of percentage of ownership but extended to daily operation and hence particularly prone to dispute.

State capitalism is the Chinese economic system fundamentally differs from western liberal market capitalism. Besides, the main reason why state capitalism has been developed in China is because the Chinese government has transformed from a command economy to a market economy (i.e., socialism with Chinese characteristics). The way that the Chinese government exercised 'state capitalism' is by directly or indirectly controlling a large number of powerful SOEs, especially in strategic and key sectors (such as China Sinopec).[10] Kratsas and Truby argue that the state direct capitalism refers to the clash of interests between sovereign and private investors, and acknowledged that Keynes's maxim that 'international cash flows are always political' is problematic.[11] There are examples from three countries which adopted state capitalism including China, Vietnam, and Singapore. In China, the Shenzhen Overseas Chinese Town Holding Company is an example of an SCE. It is a subordinate State-Owned Assets Supervision and Administration Commission ('SASAC'), and is the owner and operator of an overseas Chinese Town in Shenzhen, China. It engages in tourism, properties, and the sale of commodities. The second example of Chinese SCEs is the China National Offshore Oil Corporation ('CNOOC'). The government of the People's Republic of China and SASAC owns CNOOC which is a major national oil company in China. Finally, the China Investment Corporation (CIC) is a sovereign wealth fund responsible for managing part of the People's Republic of China's foreign exchange reserves. In Vietnam, numerous foreign investors have been attracted to invest in projects such as the Airports Corporation of Vietnam, an SCE under the Ministry of Transport of Vietnam's control. Investment has also been made to the Joint Bank for Investment and Development of Vietnam, a large state-owned bank in Vietnam and the Vietnam Multimedia Corporation, which is owned by the Vietnam Ministry of Post and Telematics. These investments also attracted enormous economic growth. In Singapore, the government owns shares in many government-linked companies and direct investment through sovereign wealth funds, most notably Temasek Holdings Private Limited, owned by the Government of Singapore. However, these SOEs might have been subjected to different corporate governance rules and a lack of clear and detailed government regulation would have weakened the internal supervision and external law enforcement, as already observed by Darmawan and Kusumaningrum.[12] Another living example happened in February 2022 when

[9] Suwinto Johan, 'Corporate Governance Principles in Sovereign Wealth Fund (The Case of Indonesia Sovereign Wealth Fund)' (2022) 23 (1) The Winners, 65, 70.

[10] Ming Du, China's State Capitalism and World Trade Law ' (2014) 63 International and Comparative Law Quarterly 409.

[11] Georges Kratsas and Jon Truby, 'Regulating Sovereign Wealth Funds to Avoid Investment Protectionism' (2015) 1 Journal of Financial Regulation 95.

[12] Andra Rahmad Darmawan and Adi Kusumaningrum, 'Law Enforcement on Indonesian Sovereign Wealth Fund to Strengthen the National Economy' (2021) 3 (2) International Journal of Law and Politics Studies, 3, 16-25.

the Norweigen oil fund used its influence as a shareholder to vote against Apple's pay policies, including the US$99m in salary and bonuses for chief executive Tim Book.[13]

To investigate this matter further, one must further relate the type of ownership SWF– broadly whether they are legal owners of their investment or merely the beneficial owners. Although the distinction appears to be de-jure because the influence would be real regardless of the legal status of their investment, the veil behind the SWFs continue to create uncertainty with regard to the access and use of information – especially whether this information is used in pure business or investment decision making, or whether there is another public interest dimension involved. How accountability is going to be lifted as an issue as well.

B. Duty to Disclose on Ground of Public Interest

Most of the projects or businesses involving SWFs investment would automatically concern public interest in both the host-state and investor-state. Whilst the concern from the public of the host-state would lie mainly in the handling of confidential information and intellectual property, the public in the investor-state would equally be concerned about the allocation of resources. In particular, where the money invested outside could mean a loss of a chance at investor-state instead of creating synergy, it may lead to social issues such as loss of employment opportunities which could have been occurred. Corporate action (such as the decision to distribute dividends) also impacts the investor-state's income. The public might demand to be informed. In the context of SWF, it is mostly reflected in terms of foreign direct investment ('FDI') through corporate mergers and acquisitions ('M&As'). The UK government has implemented legislation that would allow the UK to fend off investments from SWFs. In the UK, the Enterprise Act 2002 ('the Act') has been implemented to review corporate M&As, to ensure fair competition and protect investors from corporate M&As' situations.[14] The Act considers the merger situation once either or both of the following tests are satisfied: whether the turnover of the enterprise that is acquired has been valued over £70 million; or the resulting combined business that will account for at least twenty-five per cent of the supply of goods or services within the UK or a substantial party of it.[15] These tests are substantive, which are applied and aim to prevent the merger that might result in a substantial lessening of competition that resulted from the transaction.[16] The Act provides for government intervention if the transaction presents a risk to the public interest by affecting national security and media pluralism.[17] This piece of legislation allows the government to amend and extend the list of public interest considerations. The Department for Business, Innovation and Skills Reform aimed to provide more protections to the UK financial system by adding a category (i.e., in the interest of maintaining the stability of the UK financial system) to the list of section 58 of the Enterprise Act 2002.[18] Prentice has identified the impacts of the Act concerning the

[13] Richard Milne, 'World's largest sovereign wealth fund to vote against Apple's pay policie' *Financial Times* (Oslo, 27 February 2022) <https://on.ft.com/3pnpgCS> accessed 3 March 2022.

[14] Cosmo Graham, 'The Enterprise Act 2002 And Competition Law' (2004) 67 (2) Modern Law Review 273 (hereafter Graham, 'The Enterprise Act 2002 And Competition Law').

[15] Enterprise Act 2002, s 23.

[16] Graham, 'The Enterprise Act 2002 And Competition Law' (n 14).

[17] Enterprise Act 2002, s 58.

[18] ibid; and Explanatory Memorandum to the Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008, No. 2645.

obligation of an administrative receiver to continue to trade and on corporate security[19]. Notwithstanding the findings by Prentice, the Act has replaced complex monopoly investigations based on the Fair-Trading Act 1973 and has changed the substantive questions raised by those investigations by making the UK Competition Commission determinative in those mergers cases and market investigations.

To protect public interest against or potentially against by specifying matters' operation, the Act has set out four tests. The first test is a qualified public interest test that will apply to cases which raise specific public interest concerns (such as national security or medical, public interest).[20] The second test is a test of the prejudice to the Office of Water Supply's ability to make comparisons between water enterprises that are about to merge.[21] The third test is a substantial lessening of competition test, which will apply to all other mergers that are not covered by the first two tests.[22] The fourth test will be applied in market investigations regarding whether 'market features' have an 'adverse effect on competition'.[23]

Moreover, the Act reduced the power of the Monopolies and Merger Commission (MMC, replaced by the Competition and Markets Authority in 2014), which is an independent regulatory agency, to block the takeover and merger indirectly by judging that the transaction was 'against the public interest' and then pass it to the minister to block the takeover and merger. Currently, the MMC's power is much narrower. The minister can only block the takeover and merger because such if an operation poses a potential threat to media pluralism, financial stability or, most importantly, the national security of the UK. Moreover, the regulatory framework of SWFs in the UK is based on voluntary soft law instruments to protect the competitive markets. Walker recommended that SWFs should be regulated by the same UK code of conduct for corporate governance as any other private equity firm.[24] In the UK, SWFs are treated the same as other privately-owned firms. Santiago Principles has been adopted in the UK as voluntary international agreements.[25] Traditionally, the UK is more liberal than continental Europe. However, the investments made by SWFs have given rise to considerable political controversy and media coverage. For instance, in 2007 the former UK Chancellor, Alistair Darling (Labour Party) has publicly supported the position of the G7 that the stand toward SWFs needs to be toughened.[26] Darling suggested that the UK government would not tolerate politically motivated investments in key companies (such as British Gas). In 2007, a state-owned energy company from Russia took a stake in Centrica, which is one of the majority

[19] Daniel Prentice, 'Bargaining in The Shadow of The Enterprise Act 2002' (2004) 5 (1) European Business Organization Law Review 153.
[20] Enterprise Act 2002, s 58 (A)-(C).
[21] ibid, s 89 (1).
[22] ibid, s 47, 63.
[23] ibid, s 47, 63.
[24] David Walker, 'A review of corporate governance in UK banks and other financial industry entities- Final recommendations' (*HM Treasury*, 2009) <http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/walker_review_261109.pdf> accessed 16 January 2022.
[25] International Working Group of Sovereign Wealth Funds, 'Sovereign Wealth Funds - Generally Accepted Principles and Practices - "Santiago Principles"' (*International Working Group of Sovereign Wealth Funds*, October, 2008) <https://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> accessed 16 January 2022.
[26] Larry Elliott, 'Chancellor backs G7 move to get tough on sovereign wealth funds' *The Guardian* (Washington, 20 October 2007) <http://www.theguardian.com/politics/2007/oct/20/1> accessed 16 January 2022.

shareholders of British Gas.[27] Darling intended to warn Russia that the UK would not allow other countries to control UK's key businesses by politically motivated investment. On the other hand, in 2015, the UK government approached Abu Dhabi sovereign wealth funds, to seek investment in major infrastructure projects (including the controversial high-speed rail project, HS2).[28] Moreover, both Conservative and Labour governments have rejected new legal control based on overseas states ownership. Therefore, it showed that the UK had once taken a liberal approach towards FDIs by SWFs . Still, the National Security and Investment Act 2021 allows the UK Government to scrutinise acquisitions that are thought to be potentially harmful to the UK's national security. This could have affected entities affiliated with foreign states, although the actual impact remains to be seen. Yet, the worry is that the operation of the SWFs would no longer be governed solely by corporate governance rules drafted internally. Still, rather external law would have complicated public comprehension and accessibility of the scope of governance. This possible scope-creep arising from legal certainty triggered by changing political environment warrants further scrutiny.

C. Continuous Development of International Law

There is a gap in the law to explain any new development which might not align with the existing laws. The changes to law and regulation in both host-state and investor-state could have affected the SWFs' decision-making and appetite to invest. Some policymakers have expressed a fear that these investments could give those state investors access to sensitive security information of the host state in the infrastructure, energy, and technology sectors. Furthermore, state investors may gain control of those strategically important industries; acquire proprietary knowledge, sensitive technology and scarce resources by purchasing a controlling stake in companies. Therefore, many international organisations suggested that the SWFs should be more transparent to figure out any political investments involved. Hence, discussing the existing regulatory frameworks adopted by the EU, UK and US are necessary.

These points could be illustrated with the US and EU cases. The US adopted a protectionist approach towards those inward investments by SWFs. Since 2000, companies in the US that invested in SWFs have become a major political issue. The main regulations that burdened SWFs in the US are the Securities Exchange Act 1934, Foreign Investment and National Security Act ('FINSA') 2007, Foreign Corrupt Practices Act of 1977, and the Defense Production Act of 1950. In terms of the Securities Exchange Act 1934, this legislation is the essential US federal regulation for SWFs by requiring disclosure of information if ownership exceeds specific percentages. For instance, section 13 (D) provided a beneficial owner of more than five per cent of a company's stock to produce a statement disclosing ownership. Furthermore, section 20 of the Securities Exchange Act 1934 aims at discouraging the SWFs from buying controlling positions in a company by the concept of control of personal liability. The FINSA has set out the current view of the Committee of Foreign Investment in the United States ('CFIUS'). FINSA has greatly strengthened those regulations by CFIUS of inward

[27] Michael Harrison, 'Could Russia's Gazprom go for National Grid? It's not quite as far-fetched as it may seem' *THE INDEPENDENT* (London, 25 January 2007) <http://www.independent.co.uk/news/business/comment/michael-harrisons-outlook-could-russias-gazprom-go-for-national-grid-its-not-quite-as-far-fetched-as-433748.html> accessed 16 January 2022.

[28] Adam Bouyamourn, 'UK trains sights on Abu Dhabi sovereign funds for HS2 high-speed rail project' *THE NATIONAL* (London, 21 June 2015) <http://www.thenational.ae/business/economy/uk-trains-sights-on-abu-dhabi-sovereign-funds-for-hs2-high-speed-rail-project> accessed 16 January 2022.

investment, particularly for state-owned entitled SWFs. For instance, critical infrastructure needs to be protected against those SWFs invested with a political purpose since those vital infrastructures will give rise to an issue of national security. Furthermore, the case of *Cede & Co. v Technicolor, Inc*.[29] showed that directors and managers owned the duty of loyalty to both the company and shareholders by providing protections from SWFs' geopolitical agendas.

To regulate FDI that invests in the EU, the EU relies on treaties and EU legislation in the context of SWFs. Free trade theory (i.e., the free movement of capital within the European Common Market) is the most fundamental feature of the EU approach to regulating the SWFs. However, this fundamental feature is slightly restricted in limited cases. This is because the Treaty on the Functioning of the European Union ('TFEU') provided the competence to the EU to adopt different measures to regulate the establishment of foreign investors within the EU. There are two ways to regulate the movement of capital: first, according to Article 64 of the TFEU, the EU can impose measures on the movement of capital from third countries involving direct investment by a qualified majority; second, direct investments can be restricted by measures introduced by the EU.[30] Since the TFEU explicitly covered the relationship between member states and third parties' countries, EU laws are favourable to those foreign investors in terms of their important rights vis-à-vis their investments in the EU. However, the free movement of capital principle has been subjected to two limitations. The limitations are derogations and safeguard clauses, respectively. The scope of the limitations will determine the extent to which governments can restrict FDI in their territories. The narrower these limitations are perceived, the easier it is for SWFs to enter the EU market. On the other hand, if the limitations are broader, the government can pose more restrictions to limit SWFs' access to the Common Market. Currently, some academic commentators argue that only a few rules can be applied to regulate SWFs within the EU. However, EU law has provided a comprehensive regime to regulate foreign investors. Ultimately, EU law 'covers SWFs in the same way as any other foreign investor'.[31] The TFEU is the main piece of EU legislation that applies to SWFs.[32] As the Treaty of Lisbon has amended the Treaty of Rome, some commentators suggested that the Treaty of Lisbon has weakened the regime that regulates both the action and the establishment of foreign investors. However, this argument is flawed, because the TFEU has provided those legal frameworks and tools that are required for the EU to overcome future challenges aroused by SWFs. The post-Lisbon attribution of full FDI competencies to the EU allows for more comprehensive EU-level action. In this context, the EU has itself created an FDI screening framework.[33] This new framework works alongside national mechanisms. This is thought to be able to restrict, in effect, SWFs' access in the single market in crucial sectors.

[29] Cede & Co. v. Technicolor, Inc. [1988] 542 A.2d 1182.

[30] Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community [2007] OJ C306, Article 64.

[31] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A common European approach to Sovereign Wealth Funds [2008] COM/2008/0115.

[32] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union [2012] OJ C326/01.

[33] European Commission, *Screening of foreign direct investmen*, <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2006> accessed 3 March 2022.

Article 65 of the TFEU describes the power retained by the member states. It is the most important article for regulating the SWFs' practices in the EU. Member states are entitled to restrict the concept of free movement of capital within the European Common Market. This article set out some potential obstacles to SWFs that invest in the EU. Essentially, the implementation of Article 65 (1) (b) of the TFEU enabled those member states within the EU to restrict the capital movement from or to third countries parties or other member states based on protection of public order or public security. O'Donnell acknowledged there are several member states in the EU which have adopted various measures intended to restrict investments in the defence sector by SWFs.[34] In *Sanz de Lera and Others*,[35] the European Court of Justice ('ECJ') has produced mixed results for the development of EU law on capital movements.[36] In this case, ECJ clarified the unconditional nature of Article 65 of the TFEU that the principle of free movement of capital would prohibit those obstacles between member states and third party countries. Member states have full discretion to invoke Article 65(1) (b) of TFEU on the grounds of protecting public order or public security.[37] However, in the *FII Group Litigation v Commissioners of Inland Revenue*,[38] the ECJ held that the member states must demonstrate a particular reason to justify the restriction on capital movements to or from third-party countries by establishing a proportionality test. Until mid-2015, Article 65 of TFEU[39] has never been applied by any member state to regulate SWFs. Furthermore, measures adopted regarding the establishment of foreign investors in the EU also included conclusions of International Investment Agreements (IIAs).[40] For instance, Woolcock acknowledged that the EU has already shifted to a trade policy that envisages a greater use of Free Trade Agreements ('FTAs'). Therefore, the EU has been a significant user of FTAs.[41] In the case of EU, Chaisse had advocated that the EU avoid over-regulating and over-protecting as it has weakened the appetite of foreign investors. It is suggested that the transparency requirements should be scrutinized.[42] Despite the call, further scrutiny has been in place, such as the EU investment screening framework established in March 2019 to impose a different condition to its openness to FDI, which involves setting action of screening channel which further strengthen sharing of

[34] O'Donnell C. M., 'How should Europe respond to sovereign investors in its defence sector?' (*Centre For Euroopean Reform- Policy Brief*, September, 2010) <http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2011/pb_swf_defence_sept10-203.pdf> accessed 16 January 2022.

[35] Joined cases C-163/94, C-165/94 and C-250/94, Sanz de Lera and Others [1995] ECR 4821.

[36] Sideek M Seyad, *European Community Law on The Free Movement of Capital and EMU* (Kluwer Law International 1999) 101-102.

[37] ibid.

[38] Case C-446/04 Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue [2006] ECR I-11753.

[39] Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union [2012] OJ C326/01.

[40] United Nations Conference on Trade and Development, 'International Investment Agreements Navigator' (*United Nations Conference on Trade and Development*, 2022) <http://investmentpolicyhub.unctad.org/IIA> accessed 16 January 2022.

[41] Stephen Woolcock, 'European Union policy towards Free Trade Agreements' (2007) 3 European Centre For International Political Economy Working Paper <https://www.econstor.eu/bitstream/10419/174818/1/ecipe-wp-2007-03.pdf> accessed 16 January 2022.

[42] Julien Chaisse, 'Demystifying Public Security Exception and Limitations on Capital Movement: Hard Law, Soft Law and Sovereign Investments in the EU Internal Market' (2015) 37 (2) University of Pennsylvania Journal of International Law 583, 583.

information among EU member states through notification processes, contact points and relevant procedures to resolve issues.[43]

These measures are common to check and balance the rights and obligations of the investor-state in their involvement in the project. Nevertheless, the concern here is the appearance of the public, who is not the contractual party but has a stake in this investment. The fear of stakeholders might not be resolved by those rules, regulations, and policy because these requirements are not often apparent to the stakeholders as all they would perceive would be the level of involvement. The possible reality gap will also impose invisible fear to the threat of national security. This reality gap might not be easy to resolve due to information asymmetry.

Conclusion- Suggestion for Law Reform in United Kingdom and European Union:

Although the existing English legal system covers many of the possible FDI and corporate M&As' scenarios that might negatively affect the public interests, there are some aspects that the legal system cannot cover in its current state, especially the protection of national security that the politically motivated investment by SCEs might threaten through SWFs. To a small extent, the English legal system does not do enough to address national security concerns on the grounds of SWFs' investment by some SOEs for political purposes. The Parliament provided an example (Huawei Technologies Co. Ltd. (found by Ren Zhengfei, a former engineer in the People's Liberation Army, which implied that the company 'cannot be trusted to be free of foreign state influence')[44] that illustrated the weaknesses regarding the approach that the UK adopts for FDI in the critical national infrastructure.[45] The Parliamentary Intelligence and Security Committee suggested that the government must take further steps to mitigate the risk presented by FDI into those critical national infrastructure companies (such as BT Group plc). For instance, the Committee recommended establishing a procedure for assessing the risks and clarifying the responsibility of the role of the government department in the issue). Furthermore, in 2015 the National Security Strategy and Strategic Defence and Security Review reaffirmed those suggestions made by the Committee.[46]

Another possible angle is dispute resolution and offering investors equal treatment and protection in the event of a dispute. Usually, investors should have the right to receive 'fair and

[43] European Commission, *EU foreign investment screening mechanism becomes fully operational*, <https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867> accessed 3 March 2022.

[44] Rogers C and Ranking Member C.A. Dutch Ruppersberger of the Permanent Select Committee on Intelligence, 'Investigative Report on the US National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE' (*US House of Representatives*, October 8, 2012) <https://stacks.stanford.edu/file/druid:rm226yb7473/Huawei-ZTE%20Investigative%20Report%20(FINAL).pdf> accessed 16 January 2022.

[45] Intelligence and Security Committee, 'Foreign involvement in the Critical National Infrastructure- The implications for national security' (*Intelligence and Security Committee*, 2013) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/205680/ISC-Report-Foreign-Investment-in-the-Critical-National-Infrastructure.pdf> accessed 16 January 2022.

[46] HM Government, 'National Security Strategy and Strategic Defence and Security Review 2015- A Secure and Prosperous United Kingdom' (*HM Government*, 2015) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/478936/52309_Cm_9161_NSS_SD_Review_PRINT_only.pdf> accessed 16 January 2022.

equitable treatment' (the investors should enjoy the same treatment as the host state); [47] 'full protection and security'(the host state needs to take reasonable measures to protect foreign investors no implications for state liability); [48] "free transfer of means"(the host states need to ensure that foreign investors have the right to transfer the investment and returns); and the right not be directly or indirectly expropriated without full compensation. Those rights mentioned are substantive legal protections. It should be made explicit that investment from SWF should be treated similarly, probably through a more abrupt engagement of investor-state arbitration to settle disputes through recognised institutions such as the International Centre for Settlement of Investment Disputes ('ICSID'), which could link international investment laws, domestic law and soft law by creating a new category of investors that are specifically subject to international bodies.[49] It will create a certain degree of legal protection and stability for both the host and investor state when the function of investment treaties for public investors as well, [50] and subsequently offer more protection to home-state in the context of national security.

This paper aims to raise these three questions for future investigation and provide an alternative perspective, through the angle of corporate governance on national security that covers the common notion of physical damage and how citizens' property is safeguarded from deprivation. This deprivation is different in the sense that the control is taken over through the operation of contracts and treaties which are legitimate but could not be regarded as an integrity channel because of the potential political influence behind,[51] its ability to be used for political purpose,[52] and interfere investment decisions if it contradicts with government interest.[53] Even if these are not the intention to invest through SWF, it could impose an invisible hand that creates fear as there presents a channel for economic retaliation or other forms of support that endanger national security.[54] We believe the international legal community can expand existing rules to govern the continuous operation of SWF to better defend national sovereignty and, as a result, promote financial and economic national security.

[47] OECD, 'Fair and Equitable Treatment Standard in International Investment Law' (2004) OECD Working Papers on International Investment 2004/03 2-40 <http://www.oecd.org/daf/inv/investment-policy/WP-2004_3.pdf> accessed 16 January 2022.

[48] Mahnaz Malik, The Full Protection and Security Standard Comes of Age: Yet Another Challenge for States in Investment treaty Arbitration? (International Institute for Sustainable Development 2011) 1-12.

[49] Meg Lippincott, 'Depoliticizing Sovereign Wealth Funds Through International Arbitration' (2013) 13 (2) Chicago Journal of Internatinal Law, 649, 649 .

[50] OECD, 'Policy Framework for Investment 2006 Edition' (*OECD*, 2006) <http://www.oecd.org/investment/investment-policy/Policy-Framework-for-Investment-2015-CMIN2015-5.pdf> accessed 16 January 2022.

[51] Meg Lippincott, 'Depoliticizing Sovereign Wealth Funds Through International Arbitration' (2013) 13 (2) Chicago Journal of International Law 651.

[52] Benjamin J. Cohen, 'Sovereign Wealth Funds and National Security: The Great Tradeoff' (2009) 85 (4) International Affairs 713.

[53] Christopher Cox, 'SEC Speech: The Rise of Sovereign Business (Christopher Cox, December 5, 2007)' (Sec.gov, 2007) <https://www.sec.gov/news/speech/2007/spch120507cc.htm> accessed 21 June 2020.

[54] Victor Fleischer, 'A Theory of Taxing Sovereign Wealth' (2009) 84 New York University Law Review 14.