

CELIS Institute

CFIS 24 Background Paper on Panel

Sovereign Wealth Funds and Investment Screening

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The purpose of this Paper is to set the scene and provide the state of play and background information to the participants in Panel 7.

Are current investment screening measures equipped to differentiate between economic motives and geopolitical strategies in SWF investments?

SWF Governance: How to assess home-government influence on SWF when screening sovereign investment

SWF Strategy: How to navigate the regulatory process

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Table of Contents

- A. Introduction: SWFs as Vehicles for State-Capital Transnationalisation 2**
- B. Europe: A Target for State-led Investment 4**
- C. Qualifying SWFs 5**
 - I. SWFs Funding Models 5
 - II. SWFs: Objectives & Strategies 6
 - III. Transparency & Governance..... 7
 - IV. SWFs Co-Funding: Case Study China 9
- D. Emerging Challenges for SWFs & Investment-hosting Countries..... 11**
 - I. SWFs Interconnectivity & National Security Concerns..... 11
 - II. Joint Investment Fund Cooperations 13
- E. Emerging Strategies: How to Address Increased Scrutiny? 15**
- F. Key points: SWFs & Investment Screening 17**
- G. References: 19**

A. Introduction: SWFs as Vehicles for State-Capital Transnationalisation

The emergence of Sovereign Wealth Funds (SWFs) acting as vehicles for state-capital transnationalisation is a fairly new phenomenon that has gained traction after the Financial Crisis in 2007/08. Ever since SWFs have expanded drastically in number and aggregated size. Two decades ago, SWFs managed assets totaling over \$1 trillion USD; however, this figure has surged more than elevenfold, reaching \$11.36 trillion by the end of 2022.² China, Norway, Abu Dhabi, Singapore, and Saudi Arabia lead by assets under management, while the US, China, Australia, and Kazakhstan by the number of SWFs³. While SWFs originate from a common source of

² Megginson, Malik, and Zhou, "Sovereign Wealth Funds," pp. 253–275.

³ Cuervo-Cazurra, Grosman, and Wood, "Cross-Country Variations".



funds, they often have diverse functions, thereby overlapping their objectives. Apart from their overseas equity investments, certain SWFs serve as macro-stabilisation reserves, akin to “rainy day funds”.⁴ In the wake of the economic turmoil triggered by the COVID-19 pandemic, numerous such funds were called upon by their respective governments to serve as first responders. A cumulative total of \$211.3 billion was withdrawn from 33 funds spanning 27 countries within the initial two years of the pandemic.⁵

Some SWFs are designed to function as intergenerational saving mechanisms. SWFs can, however, also serve other purposes, such as stabilisation, regional and economic development, and fulfilling political objectives for the home country.⁶ Given their capacity to move substantial capital on a global scale, the discourse surrounding the implicit and explicit political implications of SWFs has shifted to a debate over whether SWFs are geopolitical instruments.⁷ Similar to any ownership relationship, when a SWF or State-Owned Enterprise (SOE) invests in a corporation, it receives dividends on its investment and gains a level of control through voting rights. Notably, controlling stakes in companies within critical sectors are often seen as strategically motivated and increasingly perceived as threats to national security.⁸ These threat perceptions have been particularly pronounced regarding the surge of Chinese state-led investments in European infrastructure and manufacturing companies during the mid-2010s.⁹

⁴ Megginson, Malik, and Zhou, "Sovereign Wealth Funds" p. 3.

⁵ López, D. "SWF 3.0: How sovereign wealth funds navigated COVID-19 and changed forever".

⁶ Cumming, Wood, Filatotchev, and Reinecke, "*The Oxford Handbook of Sovereign Wealth Funds*".

⁷ Kirshner, "Sovereign Wealth Funds and National Security" pp. 305 – 16.

⁸ Babic, Garcia-Bernardo, and Heemskerk, "The rise of transnational state capital" pp. 433-75.

⁹ Jungbluth, "Kauft China systematisch Schlüsseltechnologien auf?".



B. Europe: A Target for State-led Investment

Europe attracts nearly half of all global state-led transnational investments, with Asia and North America receiving approximately 25% and 16.3%, respectively.¹⁰ In particular, Western and Southern Europe emerge as an exceptional target of state capital not only in terms of investment volume but also in terms of majority investment stemming from non-OECD countries.¹¹ The implementation of the EU Screening Regulations in 2019, coupled with the impact of the COVID-19 pandemic and the Russian Invasion of Ukraine, has heightened the awareness among EU member states regarding supply chain resilience and the importance of maintaining control over strategic assets, particularly in the energy and health sector. Serving as a catalyst, these shocks to the geopolitical environment prompted a tightening of existing screening mechanisms and the introduction of new investment screening mechanisms at the national level. Increasingly, state ownership and influence are explicitly listed as key criteria to be assessed with respect to the investor in investments beyond the military and defence sectors.¹²

In light of the contemporary pursuance across the EU to develop defensive geo-economic instruments,¹³ this background paper aims to touch upon the challenges posed by SWFs to national/regional security in the context of investment screening. Firstly, the key characteristics and differences of SWFs are discussed. Secondly, the emerging challenges for SWFs and investment-hosting countries are discussed. Thirdly, strategies to facilitate the regulatory

¹⁰ Babic, "State capital in a geoeconomic world".

¹¹ Ibid.

¹² OECD, "Investment policy developments in 61 economies".

¹³ Danzman and S. Meunier, "The EU's Geoeconomic Turn".



investment screening process of SWFs are presented. Fourthly, the key takeaways of this background paper are presented.

C. Qualifying SWFs

While the nominal label of SWFs suggests their commonality as a vehicle for state capital transnationalisation, Schwarz has stressed that this oversimplified label “lumps apples, lobsters, and bliss potatoes together on the grounds that they are all colored red”.¹⁴ Due to the different objectives, management structures, sources of capital and investment policies, it is difficult to generalise SWFs.¹⁵

I. SWFs Funding Models

The funding models of SWFs can be differentiated between commodity and non-commodity-based funds.¹⁶ Whereas traditionally commodity-rich countries like the Arab Gulf States and Norway have been leveraging their excess oil and gas revenues to finance their state-led investments via SWFs, the emergence of non-commodity-based funds in countries like China and Singapore has introduced an entirely new class of SWFs, labeled “Sovereign Leveraged Funds”.¹⁷ Contrary to their commodity-based predecessors, the source of seed capital is raised through a “complicated and opaque process of debt issuances, capital transfers, and policy changes that ultimately result in the state taking on financial leverage to create the fund”.¹⁸ Like the Singaporean SWFs, both Chinese SWFs - the Chinese Investment Corporation (CIC)

¹⁴ Schwartz, "Political Capitalism and the Rise of Sovereign Wealth Funds" p. 518.

¹⁵ Kamiński, "Sovereign Wealth Fund investments in Europe".

¹⁶ Kirshner, "Sovereign Wealth Funds and National Security".

¹⁷ Liu, "Sovereign funds" p. 21.

¹⁸ Liu, "Sovereign funds" p. 187.



and the State Administration of Foreign Exchange (SAFE) - are non-commodity-based funds and thus rely on the recapitalisation of foreign exchange reserves. Accounting for the largest stock of foreign exchange reserves worldwide, China currently holds US\$ 3,246 trillion.¹⁹ While this vast amount of foreign exchange reserves serves as a powerful leverage to issue debt to finance its SWFs, the recent freezing of Russian foreign exchange reserves in response to its war in Ukraine has demonstrated the inherent geoeconomic risks associated with these reserves.²⁰

II. SWFs: Objectives & Strategies

State-led Investment via SWFs is argued to take place along a spectrum, ranging from those purely driven by the desire to secure tangible financial returns to those motivated by securing intangible strategic interests, often involving significant control over the invested entities and accessing know-how and technology.²¹ Controlling a firm does not necessarily lead to higher returns on investment, which is in most cases also not the goal of controlling strategies. If profit is the underlying motivation, diversification through portfolio investment increases the likelihood of a higher return on investment and minimises the risk of losses.²² While China transnationalises its state capital with over 87% in the form of majority or controlling stakes, other large global owners such as Norway employ a purely financial strategy by investing over 92% of its state capital in portfolio investments.²³ Other SWFs, such as the Singaporean

¹⁹ Reuters, "China forex reserves rise".

²⁰ European Commission, "Confiscation and freezing of assets".

²¹ Kamiński, "Sovereign Wealth Fund investments in Europe".

²² Babic, "State capital in a geoeconomic world".

²³ Babic, Garcia-Bernardo, and Heemskerk, "The rise of transnational state capital" pp. 433-75.



Government Investment Corporation (GIC) and Temasek, embrace mixed strategies both at home and abroad.²⁴

III. Transparency & Governance

SWFs operate with varying degrees of transparency, influenced by the governance structures of their home countries. The voluntary adoption of the Santiago Principles, established by the International Forum on Sovereign Wealth Funds in 2007, provides guidelines for governance, risk management, investment policies, and disclosure practices. These principles aim to enhance the understanding of SWFs as professional, independent, and financially oriented investors and to encourage appropriate disclosure, fostering a more open dialogue about their activities.²⁵ Although adherence to the Santiago Principles is not mandatory, numerous SWFs have embraced them as a benchmark for responsible investment management, policies, and transparency practices. According to the International Forum of Sovereign Wealth Funds, the Santiago Principles “can be of most use today, given the potential conflicts of interest that arise from the strategic beyond financial goals of SWFs.”²⁶ In light of the Santiago Principles, the Norwegian SWF exemplifies adherence to transparency and disclosure standards and is globally recognized as the most transparent fund, providing detailed portfolio information and activity reports.²⁷

²⁴ Ibid.

²⁵ International Forum of Sovereign Wealth Funds. 2024. "Santiago Principles".

²⁶ Ibid.

²⁷ Norwegian Government Pension Fund Global, "The world's most transparent investment fund".



Chinese SWFs are featured by adopting contrary approaches to each other. While SAFE is not a member to the Santiago group, CIC is committed to the Santiago principles, presenting itself as a traditional institutional investor by being “relatively transparent and pledging to be impartial to politics”.²⁸ These pursuits have been further underlined by the CIC’s inception of an international advisory council comprised of Western elite figures such as Gerhard Schröder or the former President of the European Bank for Reconstruction and Development Jean Lemierre.²⁹ In contrast to CIC, SAFE remains a relatively opaque entity that has largely evaded public scrutiny. Neither SAFE nor its associated investment funds disclose information regarding their portfolio holdings or financial performance making it difficult to assess the Funds impact on the ground.³⁰

While some SWFs are designed to function independently from a government's central authority, like the Norwegian, the situation with Chinese SWFs differs significantly. Both CIC and SAFE have consistently been led by individuals who demonstrate strong loyalty and close ties to the Communist Party. The Party carefully oversees the selection process for top positions within China’s sovereign leveraged funds, ensuring its ultimate authority over these institutions. Leaders of CIC and SAFE are handpicked and groomed by the Party's Organisational Department, solidifying the Party’s control over these entities, their operations, and mandates.³¹ Similar strong ties between the management of the SWF and the home government have been observed with the Crown Prince of Saudi Arabia and its Public Investment Fund (PIC), as well

²⁸ Liu, “Sovereign funds” p. 191.

²⁹ Global Public Policy Institute, “Gerhard Schröder’s Beijing Connection”.

³⁰ Liu, “Sovereign funds”.

³¹ Ibid.



as with other Heads of State in Gulf Arab states who wield significant influence over their respective fund operations.³² Consequently, the degree to which a country's governing executive exercises control over the management of a SWF potentially reinforces perceptions of implicit political motives in SWF transactions within investment-hosting countries.

IV. SWFs Co-Funding: Case Study China

Chinese state-led majority investments in European manufacturing companies are identified to be congruent with Beijing's industrial policy³³ underlying the objective to secure intangible strategic gains vis-à-vis economic competitors.³⁴ The unique characteristic of Chinese state-led capital transnationalisation lies in the use of both SWFs and SOEs. Unlike most countries, which typically opt for either large SOEs or SWFs, China employs both vehicles in tandem to facilitate FDI.³⁵ Both Chinese SWFs - CIC and SAFE - are argued to have financially shouldered Chinese SOEs in acquiring stakes in critical infrastructure raising national and regional security concerns in Europe and across the Atlantic.³⁶ **Figures 1 and 2** show the co-funding net of SAFE with additional state-controlled funds and SOEs.

³² Human Rights Watch, "Saudi Arabia: Investment fund linked to abuses".

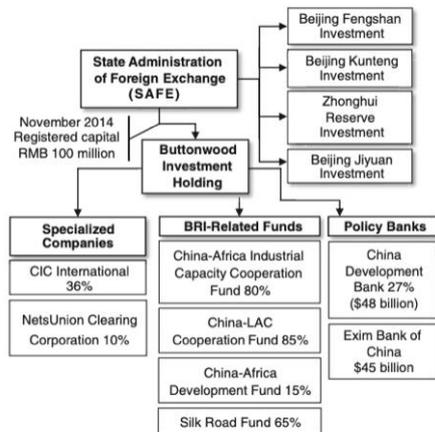
³³ Babic, "State capital in a geoeconomic world".

³⁴ Jungbluth, "Kauft China systematisch Schlüsseltechnologien auf?".

³⁵ Cuervo-Cazurra, Grosman, and Wood, "Cross-country variations".

³⁶ Babic, "State capital in a geoeconomic world".

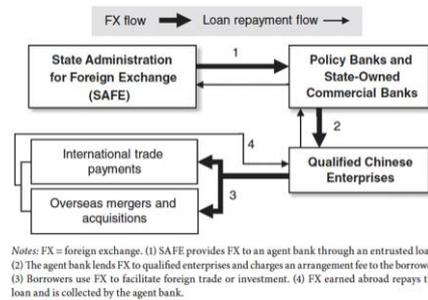
Figure 1.



Note: BRI = Belt and Road Initiative.

Figure 1. The network of Buttonwood as a SAFE-affiliated investment company. Adapted from Liu, Z. Z.

Figure 2.



Notes: FX = foreign exchange. (1) SAFE provides FX to an agent bank through an entrusted loan. (2) The agent bank lends FX to qualified enterprises and charges an arrangement fee to the borrower. (3) Borrowers use FX to facilitate foreign trade or investment. (4) FX earned abroad repays the loan and is collected by the agent bank.

Figure 2. How SAFE CO-financing works. Adapted from Liu, Z. Z. (2023)

For instance, the Silk Road Fund (SRF) which is committed to promoting high-quality development of the BRI has leveraged financial injections from SAFE to realise overseas mergers and acquisitions of Chinese SOEs in strategically sensitive infrastructure projects in Europe. Bloomberg data shows that the fund alone invested in its first three years after its launch in 2014 \$10.5 billion in Europe.³⁷ Among others, SAFE provided cash injections through the SRF to facilitate prominent takeovers, such as ChemChina’s acquisition of the Italian tire manufacturer Pirelli for \$7.7 billion and the Swiss agrochemical giant Syngenta for \$43 billion in 2015.³⁸ Moreover, physical infrastructure investments, such as the acquisition of a 24.9% stake in COSCO by Hamburg’s Tollerort port terminal in 2023, have been financially backed by SAFE, exemplifying the co-funding involvement of Chinese SWFs in SOEs.³⁹

³⁷ Bloomberg, "China’s Business in Europe".

³⁸ American Enterprise Institute, "\$7.7 billion Syngenta acquisition".

³⁹ Clark, "EU outrage clouds Hamburg Port deal".

D. Emerging Challenges for SWFs & Investment-hosting Countries

Sovereign investments have become increasingly scrutinised on grounds of national security and public order as SWFs qualify as government-linked institutions in contemporary investment screening mechanisms.⁴⁰ After the Financial Crisis of 2007/08 sovereign investment has particularly been favored by economically battered countries and companies within the EU.⁴¹ While ensuring liquidity, sovereign investment is recognised for stabilising companies and increasing their value.⁴² Moreover, sovereign investment is argued to enable firms to leverage political connections, ensure stable long-term finances, and serve as a cost-effective source of capital, thereby reducing a firm's cost of capital.⁴³ In light of these financial advantages, investment-hosting countries have faced the increasingly challenging task of balancing national security interests with the optimal allocation of capital.

I. SWFs Interconnectivity & National Security Concerns

For instance, In September 2023, Spain's economically battered Telecommunications giant Telefonica sold a 9.9% stake (worth €2.1 billion) to Saudi Telecom Company (STC) which is majority-owned by Saudi Arabia's Public Investment Funds.⁴⁴ Some discussions suggest that STC established its position with the assistance of the U.S. investment bank Morgan Stanley.⁴⁵ Over the past eight years, Telefonica has seen its value diminish by two-thirds, a decline attributed to the vigorous competition in the mobile and internet services arena, along with considerable investments in emerging technologies and market expansion efforts, as noted

⁴⁰ International Forum of Sovereign Wealth Funds, "Investing in transition".

⁴¹ El-Erian, "*Global economic trends*".

⁴² Bortolotti and Scortecci, "*Sovereign wealth funds approach*".

⁴³ Ibid.

⁴⁴ France 24, "Spain takes stake in Telefonica after Saudi deal concerns".

⁴⁵ Reuters, "Saudi Arabia's STC Group acquires 99% stake in Telefonica".



by Martin.⁴⁶ While capital was essentially needed, Spanish authorities were concerned of the acquisitions due to Saudi Arabia's "long history of human rights abuses and rampant surveillance of their populations".⁴⁷ Additional apprehensions in Spain and beyond arise regarding the involvement of Gulf countries as vital collaborators in China's Digital Silk Road, which serves as the technological component of the BRI.

The increasing interconnectivity between China and Arab Gulf SWFs has also raised national security concerns in the US. In particular, Arab Gulf SWFs, traditionally important investors in the U.S., are now facing intensified scrutiny under the Biden administration due to their financial integration and investment in China. US Officials have warned that "critical technology, infrastructure and data that get [from the US] to the UAE could potentially end up in the hands of Beijing".⁴⁸ CFIUS is currently closely reviewing several multibillion-dollar deals originating from the Middle East, including those involving the Abu Dhabi Investment Authority, Mubadala Investment, and Saudi Arabia's (PIC) amid worries of potential national security risks.⁴⁹

Given the UAE's significant state-led investments in Southern European manufacturing, with controlling investments in companies like Borealis AG and CEPSA,⁵⁰ it is crucial to recognise the interconnectedness between Arab Gulf SWFs and their financial integration through foreign direct investment with Beijing from a European perspective. With heightened scrutiny in

⁴⁶ Martin, "Are Middle East investments in the West a threat?".

⁴⁷ Ibid.

⁴⁸ *The Japan Times*, "Increasing Chinese Investment Raises National Security Concerns".

⁴⁹ Bartenstein, "Mideast wealth funds draw greater U.S. scrutiny over China ties".

⁵⁰ Babic, "State capital in a geoeconomic world".



the U.S. concerning the integration of sovereign capital between the UAE and China, these dynamics suggest analogous concerns regarding implicit channels for data and technology transfers from Europe to China through third-party SWFs.

II. Joint Investment Fund Cooperations

According to Liu, increasingly stringent FDI screening by Western governments has pushed CIC and SAFE to structure deals in more innovative and less transparent ways to pass scrutiny and obtain approval. An emerging approach is the foundation of partnership investment funds with reputable Western financial institutions operating across jurisdictions.⁵¹

For instance, in 2017, CIC launched a joint investment fund with Wall Street giant Goldman Sachs called the China-US Industrial Cooperation Partnership. This initiative allowed CIC to establish indirect holdings in critical sectors of US and UK companies amid heightened scrutiny of Chinese ownership ties. With a total investment of \$2.5 billion, the fund acquired equities, including shares in Nettitude, a company providing cybersecurity services to the British government. Moreover, the fund's investments extend to various US companies, including Cprime, a cloud computing advisory firm; Parexel, specialising in drug testing; Project44, a startup focusing on global supply chain tracking; Aptos, a retail technology provider; Visual Comfort & Co, a lighting company; and Boyd Corporation, a California-based manufacturer with products including cooling systems utilised in machine learning and drones.⁵²

⁵¹ Liu, "Sovereign funds".

⁵² Wiggins and Louch, "Goldman Sachs bought UK and US companies using Chinese state funds".



While CIC is only the anchor investor of the partnership fund, and Goldman its sponsor, the CIC is not entitled to advise daily operational and investment opportunities.⁵³ In 2019, the joint partnership demonstrated its effectiveness when Goldman successfully persuaded CFIUS to allow the proposed acquisition of Boyd Corp, a prominent manufacturer of engineered materials and thermal management technologies, to proceed. Initially, CFIUS requested CIC to divest from the deal due to data privacy concerns and national security grounds.⁵⁴

As part of the Belt and Road Initiative (BRI), CIC has pursued a similar approach in Europe with the establishment of five investment corporation partnerships in collaboration with leading international banks in Germany, France, Italy, Ireland, and the UK (see Figure 3).

TABLE 3.7 CIC joint cooperation funds

<i>Inception Date</i>	<i>Name of Fund</i>	<i>Fund's Capitalization (CIC's Stake)</i>
June 2012	Russia-China Investment Fund	\$2 billion
Jan. 2014	China-Ireland Technology Growth Fund	\$100 million (\$50 million)
Aug. 2015	Asia-Germany Industry 4.0 Promotion Cross-Border Fund	Unknown
Nov. 2017	China-US Industrial Cooperation Partnership, LP	\$5 billion (\$2.5 billion)
March 2018	China-Ireland Growth Technology Fund II	€150 million (€75 million)
Oct. 2018	Japan-China Industrial Cooperation Fund	Target ¥100–200 billion
Sept. 2019	China-Russia Science and Technology Innovation Fund	\$1 billion
Dec. 2019	CIC-HSBC Fund	€1 billion (€500 million)
June 2020	France-China Cooperation Fund	€400 million
Oct. 2020	China-Italy Industrial Cooperation Fund	€600 million

Source: Author-collected data from publicly available information.

Figure 3. CIC Joint Cooperation Funds. Adapted from Liu, Z. Z. (2023)

⁵³ Liu, "Sovereign funds".

⁵⁴ Brumpton, Wang, and Baker, "Exclusive: Goldman's China-backed fund bucks".



The approach involving the establishment of joint cooperation funds has the potential to further obscure the activities of Chinese SWFs by leveraging influential institutional investors in host countries, while simultaneously creating a perception of detachment from the Communist Party.⁵⁵ Ultimately, this approach has been portrayed as a strategic maneuver to channel state capital in sensitive industrial sectors overseas, bypass administrative hurdles, and circumvent heightened scrutiny by investment-hosting governments, which increasingly view Chinese investment as a security threat.⁵⁶

E. Emerging Strategies: How to Address Increased Scrutiny?

To navigate the regulatory processes of investment screening mechanisms across jurisdictions little is to be found on concrete strategies taken by individual SWFs to address these emerging challenges. Mc Baker Kenzie has published the following best practice methods in 2021:⁵⁷

Early Risk Assessment: Conduct an early risk assessment to identify potential national security concerns. This helps maintain a strong negotiation position and allows for better assistance from the target during the regulatory review process. Early assessment is crucial due to rising political and economic sensitivities, especially for government-owned or controlled investors.⁵⁸

⁵⁵ Liu, "Sovereign funds".

⁵⁶ Ibid.

⁵⁷ Baker McKenzie, "Strategies for Navigating the Global Foreign Investment Landscape".

⁵⁸ Ibid.



Considering Co-Investor Risk Profile: Authorities scrutinize investor identities, focusing on control levels. Co-investing with parties viewed more favorably by authorities can mitigate risk. Certain jurisdictions offer lower restrictions or require local partners in sensitive sectors.⁵⁹

Understanding the Process and Engage Early: Screening processes vary widely, especially in multi-jurisdictional deals. Sovereign wealth funds need both global and local expertise to navigate these processes and should seek formal or informal guidance from authorities early on to identify potential risks.⁶⁰

Crafting a Public and Government Relations Strategy: Investment reviews are often political and influenced by media perception. Developing strong political and media strategies is crucial to highlight the transaction's benefits to the host country's workforce, economy, and global reputation.⁶¹

Preparing for Detailed Disclosures: SWFs should expect detailed information requests from regulatory bodies regarding the fund, its investments, ownership, and key individuals. Transparency is key to facilitating the review process.⁶²

Allocating of Risk and Responsibility: SWFs are advised to involve regulatory counsel early to address risks in the transaction agreement. Understand the target's relationship with the host

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Ibid.



country's government, including any government contracts, security clearances, and proximity to sensitive facilities.⁶³

Considering Mitigation Measures: SWFs should identify potential mitigation measures before filing notifications or applications. Pre-filing consultations with local authorities can help determine necessary actions for approval and allow for transaction modifications to address risks upfront.⁶⁴

F. Key points: SWFs & Investment Screening

SWFs raise national security considerations because they are perceived as potential tools for pursuing political agendas and advancing the strategic interests of their home governments vis-à-vis the investment-hosting country. In current investment screening mechanisms, SWFs fall under the criteria of government-linked institutions and are exposed to increased scrutiny. Contemporary national security considerations of SWF investments address potentially threatening relationships beyond the SWFs' ties to the investment-hosting country.

From a government perspective, an emerging challenge to national security is addressing investment activities and financial integration in other countries, particularly China. While investment-hosting countries remain wary of sovereign investment in critical infrastructures, the example of Gulf Arab SWFs investing in China and Beijing's flagship foreign policy

⁶³ Ibid

⁶⁴ Ibid.



initiatives like the Digital Silk Road have raised concerns that Gulf Arab SWFs could function as vehicles that channel data and know-how from Europe to China through their investments. Moreover, the Chinese practice of forming cooperation with internationally active banks has raised national security considerations, as demonstrated by a recent CFIUS review in the US.

As SWFs differ significantly in funding, objectives, strategies, and governance, it is essential to engage in a dialogue about how screening authorities qualify SWFs and how SWFs can efficiently navigate the regulatory process. The Santiago Principles have laid a foundation for transparent investment but have not prevented increased scrutiny of sovereign investment stemming from its SWF members. Therefore, the evolving threat perceptions surrounding SWFs require dialogue and clarification to further increase transparency, reduce transaction costs, and maintain an open investment climate. Governments, regulatory bodies, Counselors, and SWF representatives should engage in this dialogue.

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