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CHINA'S SOVEREIGN INVESTMENT FUNDS IN INTERNATIONAL PERSPECTIVE: THE EXCEPTIONALISM OF CIC AND SAFE

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Abstract

China is the only country in the world with two sovereign investment vehicles dedicated to managing excess foreign reserves for return, not just safety and liquidity. As the investment profile and behaviour of both funds align with the aims of the government's economic agenda, it is tempting to view China's two sovereign funds as forming part of a deliberate, coordinated strategy to further state policy. However, analysis of the origin of China's multi-fund sovereign investment regime shows that this approach is primarily a product of intense bureaucratic rivalry within the Chinese public service, rather than a considered strategy of the sponsoring government. This historical account of China's exceptionalism in sovereign investment suggests that there is no inherent reason why China's sovereign investors should be outliers in terms of institutional design and governance. Yet, regional and international comparison reveals precisely that: relative to peer funds such as the Hong Kong Monetary Authority (HKMA) and Korean Investment Corporation (KIC), China's investment vehicles lack robust mechanisms to achieve effective arms-length governance from their state sponsor. A series of reforms to the Chinese funds to ensure greater clarity of mission and alignment of purpose with internal decision-making would encourage Chinese exceptionalism in sovereign investment management becomes exemplary rather than anomalous.

Key words: Sovereign wealth funds; China; governance; organisational design.

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1 Introduction

China boasts two of the world's largest and most high profile sovereign investors. The China Investment Corporation (CIC) and the State Administration of Foreign Exchange (SAFE) are estimated to hold over US$1 trillion between them and regularly appear in the top 5 rankings of sovereign wealth funds (SWFs) based on assets under management.[1] They are both risk-taking investors with relatively high return appetites. Both entities have complicated, opaque organisational structures and are tightly controlled by the highest levels of the Chinese government. Their known investment behaviour shares much in common, displaying a concentration of activity in finance, commodities, technology and energy, all sectors deemed strategic priorities by the Community Party leadership (Balding and Campbell, 2013). It is tempting therefore, to view these funds as comrades in a united effort to further China's global economic agenda.

A close comparison of the origin and design of the CIC and SAFE however, reveals that these are fundamentally different types of sovereign investment vehicles with distinct agendas and sources of authority within the state bureaucracy. As a growing body of research has shown, they are fiercely competitive rivals vying for control of China's substantial foreign exchange reserves, the largest globally since 2006 (Balding and Campbell, 2013; Eaton and Ming, 2010). This article builds on that analysis by demonstrating how both the CIC and SAFE are not only competitors with one another, but outliers within their respective cohort of peer funds. Relative to regional peer investors such as the HKMA and KIC, China's funds lack the machinery for proper arms-length operation, emerging as irregularities within the global sovereign investor landscape. Combining an historical and comparative account of China's approach highlights both the potential for, and type of, reforms necessary to align the CIC and SAFE with global best practice, transforming Chinese sovereign investment from exceptional to exemplar.

This article describes and explains China's exceptional approach to sovereign wealth management over six sections. Sections 2 and 3 overview the Chinese sovereign investor landscape, situating the CIC and SAFE within the global universe of public investors. Section 4 distinguishes between CIC and SAFE, describing how they are novel institutions dedicated to the same task of managing surplus reserves for commercial return. Sections 5 identifies the novelty in China's multi-fund approach to managing sovereign wealth, while Section 6 offers a historical and institutional explanation for how this evolution of this system, highlighting the intense rivalry within the Chinese bureaucracy for control over the reserves as the primary explanation for the design of these entities. With a clearer characterisation of CIC and SAFE, Section 7 compares the structure, governance and institutional arrangements for both funds with peer vehicles to highlight the lack of best practice in the design and operation of China's entities. Section 8 concludes.

[1] See the Sovereign Wealth Fund Institute Fund Rankings at http://www.swfinstitute.org/fund-rankings/; ESADEego Sovereign Wealth Funds Ranking 2013 in Santiso (2013); and the Institutional Investor Sovereign Wealth Center Fund Rankings at http://www.sovereignwealthcenter.com/fund-profiles.html

2 The global public investor universe

The public investor community is vast. A recent estimate of the largest 400 public pension funds, SWFs and central banks globally put total holdings at $29.1 trillion (OMFIF, 2014). I use the terms 'public', 'state' and 'sovereign' interchangeably[2] to mean any government-sponsored entity that manages and invests state (whether national or subnational) financial assets in domestic and/or global capital markets. This universe can be arranged into three categories of vehicle:

- *Sovereign wealth funds:* special purpose investment vehicles funded out of balance of payments surpluses, official foreign currency, privatisation proceeds, fiscal surpluses, and/or receipts resulting from commodity exports and which employ investment strategies that include investing in foreign financial assets. This excludes state-owned enterprises, government-employee pension funds (contra public pension reserve funds) and central banks assets used for traditional balance of payment purposes (IWG, 2008: 27).

- *Public pension funds*: funds focused on long-term investment to help meet future pension needs of government employees or social security for citizens generally. The capital of these funds is generated by standard pension and social security contributions and the funds are constrained by near-term liabilities. Some nations accumulate all or many public sector pensions into one fund (eg. the PIC in South Africa manages money on behalf of 23 different public sector clients) while other governments create dedicated funds for different sectors (eg. the Ontario Teacher's Pension Plan Board [OTPPB], Railway Pension Fund [Netherlands], Ohio Police and Fire Pension Fund etc).

- *Central banks*: monetary authorities that manage national foreign exchange (FX) reserves for safety and liquidity by holding short-term, highly liquid, safe haven securities. Some central banks have diversified a portion of their reserves into higher-return seeking assets including equities and alternatives given the low yield fixed income environment (Marsh, 2014). A small number of monetary authorities have done so by creating a *permanent* investment tranche with their surplus reserves that is separate to their liquidity portfolio.

Each of the three categories contains numerous models within it, summarised in Table 1 below. The SWF category is the most multifarious, comprising of at least five distinguishable fund types. While there is some disagreement about what institutions belong to which category—for instance, some scholars classify public pension funds and pension reserve funds as SWFs (Truman, 2010: 10)—our main task is to provide a clear taxonomy of the universe of sovereign *investment* vehicles as opposed to other public entities such as state owned enterprises (SOEs). SOEs are excluded from the above framework since they are ultimately government-owned *business* contra

[2] The use of 'sovereign' is more controversial than 'public' since for some commentators 'sovereign' implies a national level government who is fully sovereign in terms of its law-making capacity. For discussions on the contested meaning of 'sovereign' in the SWF label, see Dixon (2013).

investment entities whose basic purpose is to undertake commercial activities on behalf of a government.[3]

[3] China's SOE sector is vast and its investment behavior and reform is the subject of debate. This paper will not examine China's SOEs. For a useful overview of China's SOE sector, see OECD (2009).

Table 1: China's sovereign investors in the global sovereign investment universe

Category	Fund type	Select Examples
Sovereign Wealth Funds (SWFs)	Pension Reserve Fund	Future Fund (Australia); New Zealand Superannuation Fund; Chile Pension Reserve Fund
	Reserve Investment Corporations	**China Investment Corporation (CIC);** Korea Investment Corporation (KIC); Government of Singapore Investment Corporation (GIC)
	Savings Funds	Abu Dhabi Investment Authority (ADIA); Alaska Permanent Fund; Qatar Investment Authority; Botswana Pula Fund
	Stabilisation Funds	Economic and Social Stabilisation Fund (Chile); Mexico Oil Stabilisation Fund; Iran Oil Stabilisation Fund; Azerbaijan State Oil Fund
	Development Funds	**China-Africa Development Fund (China);** Mubadala (UAE); National Development Fund (Iran); Samruk-Kazyna (Kazakhstan); Temasek (Singapore); Khazanah (Malaysia)
Public Pension Funds	Government Employee Pension Fund	Government Pension Investment Fund (Japan); National Pension Service (South Korea); Public Investment Corporation (South Africa); Ontario Public Service Employees Union
	Social Security Funds	**National Social Security Fund (China);** United States Social Security Trust Fund; Public Institute for Social Security (Kuwait)
Central Banks	Central Banks Reserve Portfolios	Nearly all nations possess a central bank or monetary authority responsible for managing the conventional reserve portfolio for liquidity
	Central Bank Investment Tranches	**SAFE investment portfolio (China**); Botswana Pula Fund; Hong Kong Monetary Agency (HKMA); Saudi Arabian Monetary Agency (SAMA) investment portfolio

Source: IMF (2013) and IWG (2008)

3 Situating China's state investment funds in the public investor universe

China is one of only a handful of states with multiple sovereign investment entities.[4] Table 1 above shows that China has at least four, separate sovereign investment entities in addition to its central bank, the People's Bank of China (PBOC). Table 1 situates each of these entities within the categories of our sovereign investor framework, showing that China possesses a reserve investment corporation, public pension fund, central bank investment portfolio and a development fund as follows:

- <u>Reserve investment corporation:</u> China Investment Corporation (CIC), established 2007, managing $652bn, is mandated to diversify a portion of China's foreign exchange reserves into higher return assets. The CIC was initially capitalised with $200bn in foreign reserves, purchased by the Ministry of Finance with funds raised through a 1.55 trillion yuan bond issuance.

- <u>Public pension fund</u>: National Social Security Fund (NSSF), established 2000, managing $178bn, is a strategic reserve fund mandated to help the provinces with pension financing difficulties. Its funding sources include allocations from the central government, lottery license fees, State Shares equal to 10 per cent of IPO proceeds and investment returns. The NSSF is mainly a domestic investor, restricted to a 20 per cent global allocation of funds and is the largest institutional investor in China's pension sector.

- <u>Central bank investment portfolio</u>: SAFE Investment Portfolio (SAEF-IP, began 1997), estimated to manage approximately $300bn in FX reserves (but the Chinese authorities have never confirmed this total), understood to be allocated to equity and alternative investments overseas. SAFE is the investment management branch of the PBOC and is responsible for conventional reserve management as well as managing a tranche of assets allocated to higher risk-taking investment strategies abroad. The latter is believed to occur primarily through five overseas investment arms in Hong Kong (est. 1997), London, New York, Singapore and Frankfurt.

- <u>Development fund</u>: China-Africa Development Fund (CAD, est. 2007) manages $5bn ear-marked for investment in Africa. The CAD fund is mandated to foster economic ties between China and Africa by investing in stocks, convertible bonds, fund of funds and other quasi-equity type of investments in Africa (CAD, 2014).[5] It functions as a branch of the China Development Bank (CDB), China's largest policy bank and one of the largest issuers of bonds in the PRC. The CDB is majority owned by Central Huijin, the domestic subsidiary of CIC, but appears to operating independently.

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[4] The highest number of sovereign investment funds within one political community is five, housed in Abu Dhabi, the capital emirate of the UAE. While there are countries with more funds within their territorial borders, no one government sponsors as many entities as the Abu Dhabi government. For instance, the US currently boasts 16 sub-national funds across ten states, meaning America as a country possesses the highest number of SWFs in the world, but no US state government controls as many funds as five funds. See Oxford Analytica (2013)

[5] For a typology of 'Sovereign Development Funds (SDF), see Monk and Dixon (2014)

While all four of these investment vehicles help the Chinese government administer, manage and invest its public financial assets, this article will restrict its focus to the CIC and SAFE-IP for three reasons: first, as the two largest Chinese funds, the investment patterns of CIC (holding $652bn) and SAFE-IP (estimated to hold roughly $300bn) have potential to wield greater impact on recipient countries and global markets just by virtue of size; second, the portfolios of CIC and SAFE-IP are more global than those of NSSF and CAD, with the latter restricted to investing in Africa and NSSF limited to an international allocation of 20 per cent of its portfolio; and third, the institutional missions of the CIC and SAFE-IP are vaguer than those of the NSSF and the CAD, whose investment mandates directly reflect their clearly articulated organisational objectives. While the NSSF's obligation to fund domestic social security liabilities demands a heavy bias towards local assets and the CAD's investment strategy is geographically limited to Africa given its objective to enhance strategic China–Africa partnerships, the CIC and SAFE-IP's precise role within Chinese economic policy framework is still evolving. An understanding of their structure, governance and investment behaviour is therefore of more relevance when seeking to understand the international significance of China's sovereign investors.

4 Distinguishing CIC And SAFE-IP: Are They Both SWFs?

China's two largest sovereign investment vehicles are distinct institutional beasts. While CIC self-identifies as a sovereign wealth fund, is a member of the International Forum of SWFs (IFSWF) and China's only officially recognised SWF (Koch-Weser and Haacke, 2013: 4), SAFE-IP's status as an SWF is contested. Under the framework presented above, both funds belong to different categories of sovereign investor. CIC is a classic reserve investment corporation, a fund typically counted in the SWF universe. The IMF (2013) identifies reserves investment corporations as one of five types of sovereign wealth fund, describing them as vehicles that 'intend to reduce the negative carry costs of holding reserves or to earn [a] higher return on ample reserves'. Such funds are created with FX reserves removed from the custody of the central bank and allocated to a separate, independent authority for management. All or some of each fund's assets is counted as part of their sponsor country's official reserves.

In contrast, SAFE is the investment management arm of the PBOC, the country's monetary authority. Under our framework, FX reserves allocated to higher return, higher risk-seeking investment portfolios *within* a central bank are described as central bank investment portfolios (CBIPs).[6] These internal investment tranches within monetary authorities are sometimes counted as SWFs insofar as they manage surplus reserves for commercial return and thus, look identical in function and behaviour to reserve investment corporations. On this basis, SAFE-IP has sometimes been characterised as a sovereign wealth fund as have peer CBIPs in the Hong Kong Monetary Authority (HKMA), the Saudi Arabian Monetary Agency (SAMA) and the Botswana Pula Fund.[7]

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[6] Others have suggested different terminology, describing central banks which pursue such investment strategies with excess reserves as 'Diversified Monetary Authorities'. See footnote 22 of Rozanov (2011) referencing Alastair Newtown.

[7] For instance, the Sovereign Wealth Institute and Sovereign Wealth Centre at Institutional Investor include SAFE-IP, SAMA's investment portfolio, the Hong Kong Monetary Authority Exchange Fund (HKMA-EF) and the Pula Fund in the Bank of Botswana in their respective sovereign fund universes.

However, CBIPs can be distinguished from reserve investment corporations and indeed, all SWFs on the basis of their lack of organisational independence. While reserve investment corporations are separate authorities operating outside the traditional organs of the state, CBIPs sit under the institutional umbrella of monetary authorities with clear implications for their governance arrangements and investment strategies. Moreover, HKMA, SAMA and SAFE are not IFSWF members and all explicitly resist the SWF label, despite the presence of investment portfolios within their organisations. It is therefore constructive to institutionally distinguish between investment vehicles that sit within a central bank and those that exist as independent organisations, operating as stand-alone entities. CIC is a sovereign wealth fund, while the investment arm of the SAFE is a central bank investment portfolio. While both manage sovereign wealth or 'excess reserves' for commercial return, they constitute unique institutional models for undertaking sovereign investment and accordingly, are better compared and contrasted to their peers then to each other when trying to gain a proper understanding of their behaviour.

5 China's Multi-Fund Approach To Managing Sovereign Wealth

China is one of very few states to invest (not just administer) its excess reserves both through its central bank and a specially created SWF. Such states can be described as having a 'multi-fund' approach to managing their sovereign wealth. A multi-fund regime typically takes one of three forms:

- **Scenario 1**: a government divides up the same pot of sovereign wealth (whether foreign reserves, pension assets or commodity revenues) among several of the same type of sovereign investment entity. Classic examples here include Abu Dhabi with four sovereign wealth funds all financed by commodity revenues, or Sweden which for many years, has allocated its pot of public pension capital among five, separate funds.

- **Scenario 2**: a government uses different sources of public capital to establish multiple of the same type of sovereign investment entity. Singapore possesses two sovereign funds—Temasek and the Government Investment Corporation (GIC)—funded by different sources of public capital. While Temasek was set up in 1974 with privatisation proceeds, GIC was established in 1981 with excess reserves.

- **Scenario 3**: a government allocates the same pot of sovereign wealth (typically reserves) to different types of sovereign investment entity. Here, China offers a textbook example with its surplus reserves managed both by the PBOC and the CIC. Korea and Singapore have also established separate reserve investment corporations outside their central banks. However, China manages its reserves across more entities since it has both a dedicated SWF in addition to a CBIP within its monetary authority, both tasked with diversifying foreign reserves.[8]

In contrast, Peterson Institute fellow Ted Truman includes SAMA, HKMA-EF and the Pula Fund on his list of 83 sovereign funds, but excludes SAFE-IP. See Truman (2010) 166.

[8] States which only have a central bank investment portfolio in addition to their reserve portfolio within a central bank do not count as multi-fund regimes since all investment activities occur within the one

There is different rationale for each scenario. In scenario 1, common motivations for creating several similar funds to manage the same pot of money include creating competition to improve performance, risk-sharing or decentralising control. Scenario 2, in which different types of public capital are given to similar but separate sovereign investors is more intuitive since a government may wish to assign different risk profiles, return targets and missions to its distinct pots of public capital. The final scenario, of which China is illustrative, tends to be driven by institutional capability. Where a country develops new ambitions for a chunk of its sovereign wealth, often those ambitions are better realised by a new, independently mandated organization equipped with the specific capabilities and skill set for that separate task. This is precisely what occurred in Singapore and Korea who both set up stand alone reserve investment corporations to invest a portion of their FX reserves more aggressively and with greater risk-taking scope than their central banks. China also established such an entity in the form of the CIC, however, unlike Singapore and Korea, China ended up with both a CBIP inside its central bank in the form of SAFE-IP and a reserve investment corporation in CIC. Why did China create several different types of sovereign fund to manage and invest the same port of public assets and in what ways do SAFE and CIC differ from or resemble their respective sovereign investor peers—CBIPs and reserve investment corporations respectively—that may shed light on their motives and behaviour?

6 The Emergence Of Two Investment Vehicles For China's FX Reserves

To understand the distinct roles of China's two FX reserve investors and to appreciate why China, unlike its regional peers manages its vast excess foreign reserves across different entities, this section reviews the establishment and evolution of the SAFE investment portfolio and the CIC. This review suggests at least two possible explanations for China's exceptional institutional approach to managing sovereign wealth: first, the sheer scale of China's reserves partly explains the need for multiple vehicles to help manage those enormous assets. But given the relatively small proportion of excess reserves that was transferred as seed capital to the dedicated reserve investment corporation, this explanation fails to fully capture what drove China's behaviour. The second explanation highlights the intense bureaucratic rivalry between China's main financial management entities, and better accounts for some of the institutional design anomalies in China's approach to managing excess reserves.

6.1 The establishment and evolution of SAFE-IP

SAFE, in its current form, was set up as the country's foreign exchange regulator as a subsidiary of the PBOC in 1979 following liberalisation of the Chinese economy. Prior to this, foreign exchange reserves were extremely limited. Under central planning in the Mao period, monetary policy was subservient to state planning. The PBOC was a state-owned commercial bank (SOCB) that took on only limited functions of a central bank and did not have ministry status. It was subordinate to Ministry of Finance (MOF), which had ownership rights over all the SOCBs. With economic liberalisation under Deng Xiaping, the PBOC was granted independence

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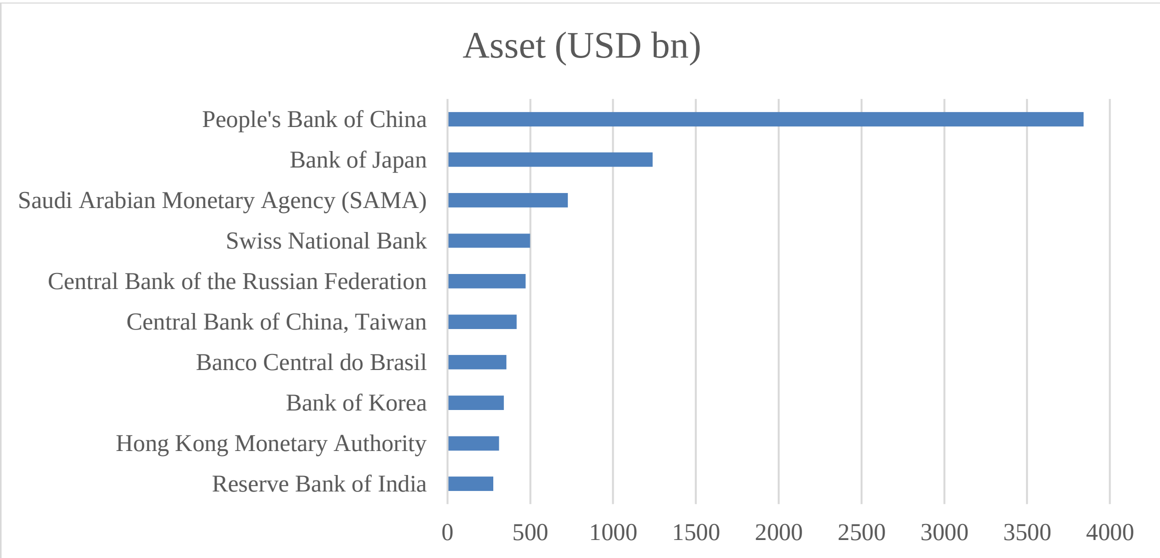
organisation. For instance, Hong Kong, Botswana and Saudi Arabia are not multi-fund regimes on this understanding since their investment entities all sit within their central banks.

from the MOF and was officially designated China's central bank in 1983. It continued to act as both a commercial bank and a lender of last resort until that time.

Economic liberalisation opened up space for political contest among various entities within China's bureaucratic apparatus. Key public institutions exploited their new policy freedom as well as China's fragmented political authority to contest their design and attempt to expand their influence (Liew and He, 2013: 26). This period marked the beginning of a long-running rivalry between the PBOC and SAFE on the one hand, and the MOF on the other, where both organisations have competed to secure a 'long-term powerful niche within China's bureaucracy' (Balding and Campbell, 2013: 48). They do so by vying for control of the country's substantial foreign reserves, a rivalry helps explain the evolution of China's public finance architecture including the creation of the CIC as the country's first SWF in 2007.

SAFE's role has become significantly more complex since its establishment when China possessed just $167 million in FX reserves. In the 35 years since, China's reserves increased year-on-year since 1992 broke the $1tn mark in 1996 and officially became the largest reserves globally in 2006 (Balding and Campbell 2013, 6). As Table 2 shows, China still enjoys that status today with just over $3.8tn in reserves.

Table 2: Top 10 FX Reserve holdings globally 2013



Source: IMF IFS (2014) showing total reserves for 2013 (end Dec)

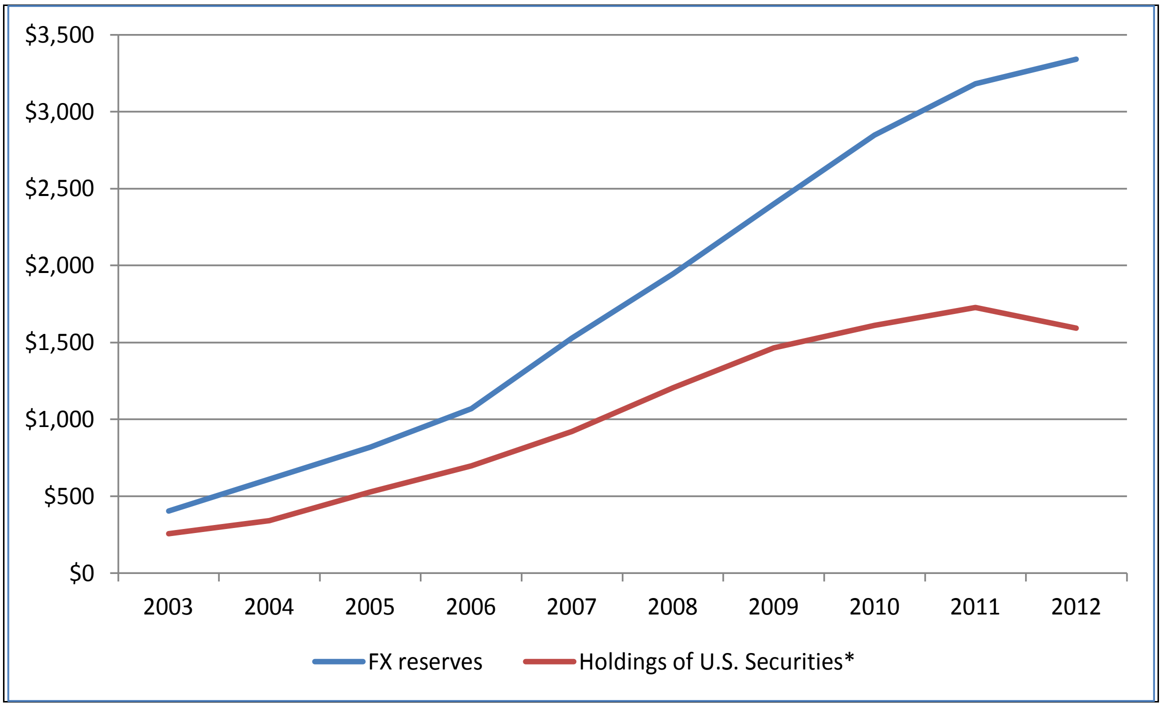
In conjunction with the expanding reserves, SAFE gained and welcomed greater responsibilities as part of its effort to improve its stature within China's bureaucracy. In addition to is delegated task of administration and management of China's foreign reserves, in 1982 it assumed a leadership role within the PBOC, followed by responsibility for monitoring the foreign exchange swap market (1986); verifying import payments and improving the export payments verification process (1997) and more recently, approval of Chinese outward direct investment and monitoring repatriation of Chinese overseas investment profits (Balding and Campbell, 2013: 47). SAFE's many responsibilities are undertaken by a large, opaque organisation headquartered in Beijing, which consists of 9 functional branches responsible for regulating the Chinese balance of payments, current account, capital account and foreign exchange reserves (SAFE, 2013: 8). One of these branches, the Reserve Management arm, is tasked with operating and managing the state foreign exchange reserves according to relevant national strategy and principles. SAFE reports directly to the State Council and the Communist Party of China (CPC) Committee.

1997: The beginning of SAFE's international operations

As part of its effort to more effectively manage China's rapidly expanding reserves and to offset depreciation of the US dollar in which most of China's FX reserves are held (Salidjanova, 2014: 2), SAFE began establishing overseas offices to carry out international investments. The first subsidiary was established in Hong Kong in 1997, one month before Hong Kong's hand-over from Great Britain to China and capitalised with about $20 billion to 'support and promote the development of Hong Kong's financial market' (Anderlini, 2008). Named the SAFE Investment Company (SAFE IC), in its early life, the subsidiary operated as a minor outpost of SAFE, mimicking the conservative investment strategies of the Beijing headquarters, albeit with a crucial role of defending the value of the renminbi and Hong Kong's peg to the US dollar against international speculators.

Since then, SAFE has created additional overseas offices in Singapore, London, New York and Frankfurt. The role of these offices appears to be to help diversify China's FX reserves through higher return seeking assets abroad. The satellite offices are managed by an 'affiliated institution' called the SAFE Investment Center (SAFE, 2013: 9). SAFE does not refer to these offices as forming part of an investment tranche or strategy, but instead describes its overseas operations as an 'international investment platform with supporting points in Beijing, Singapore, Hong Kong, London, New York and Frankfurt' (SAFE, 2013: 90). Indeed, it did not even admit the existence of its Hong Kong subsidiary until 2008 when it was confronted with inconvertible evidence (Anderlini, 2008). Despite its opaqueness, others have characterised this international diversification move as tantamount to SAFE 'quietly open[ing] up its own investment management portfolio' (Balding and Campbell, 2013: 46). Figure 1 below shows that the trend towards diversification commenced in 2007 as China began to move its reserves away from US Treasuries. While US Treasuries still constitute 'the lion's share of China's officially registered foreign exchange reserves, their proportion has declined from around 63 per cent in 2003, to less than 50 per cent in 2012' (Salidjanova, 2014: 2). It seems plausible then that the creation of these overseas offices forms part of the scaffolding for a de facto investment portfolio within SAFE.

Figure 1: China's Foreign Exchange Reserves and Holdings of U.S. Securities, 2003-2012 (USD billions)



Source: Salidjanova (2014)

1998-2003: Asian Financial Crisis and Reform

It took crisis and reform however, to help crystallise a disparate set of international diversification moves into an investment management strategy within SAFE. The turning point came with the Asian Financial Crisis of 1997–98. At the time, Zhu Rongji (1998–2003), a former PBOC governor, was the country's Premier. Premier Zhu sought to reform China's banking sector to better equip it to serve the modern market economy that China's leaders had decided to create, a mission that was given great impetus by the crisis. The crisis exposed the dangerous levels of undercapitalisation in China's state-owned banks as well as the scale of non-performing loans to similarly underperforming state-owned enterprises (SOEs) on the bank's balance sheets (Liew and He, 2013: 28–29). The first step in China's banking reform was recapitalisation of the major state-owned commercial banks to raise their capital-adequacy ratios to the Bank for International Settlements (BIS) benchmark of 8 per cent (Lau, 1999). In August 1998, the capital base of the four major state-owned banks—Bank of China (BOC), China Construction Bank (CCB), Industrial and Commercial Bank of China (ICBC) and the Agricultural Bank of China (ABC)—was more than doubled. The next step was to clean the non-performing loans from the balance sheets of the four banks.

Reform of the banking sector gave the PBOC (and SAFE) an opportunity to raise its status in the country's bureaucratic hierarchy since regulation and supervision of the country's state-owned banks fell within its remits. However, kudos came at a price, as the MOF as 'owner' of the banks would profit from their reform (Liew and He, 2013: 29–30). Ultimately, the financial reforms initiated by the central bank benefitted the finance ministry at the expense of PBOC, whose balance sheet was weakened by the interventions, exacerbating the competitive relationship between the two institutions.

These short-term responses to the financial crisis had revealed deeper, structural problems in the Chinese economy, not least of which were the SOEs' balance sheets. But restructuring these entities was politically sensitive given the vast numbers of Chinese citizens employed by SOEs. At the same time, a different pressure emerged to force further banking reform. China's admission to the WTO in 2001 required it to lift the ban on entry to foreign-owned banks and strengthen its banking sector. The MOF as sole owner of the state-owned banks could not recapitalise them by itself. Subsequent research revealed that the cost of cleansing the banks of non-performing loans was as much as 30 per cent of 2005 GDP (Ma, 2006). Since the PBOC was not willing to intervene again to its detriment, the government was forced to initiate a radical overhaul of bank ownership. This allowed it to meet the conditions of WTO membership without embarking on a controversial clean up of the SOE sector. A 2003 Party Congress established the Central Leading Group on Reforming the Shareholding of SOCBs (CLG) to oversee the bank ownership overhaul. This period of rapid, deep reform provided the precursor for the creation of a sovereign wealth fund, a demand which in turn triggered SAFE to create is investment portfolio.

2003: Birth of Huijin Central, a quasi sovereign fund

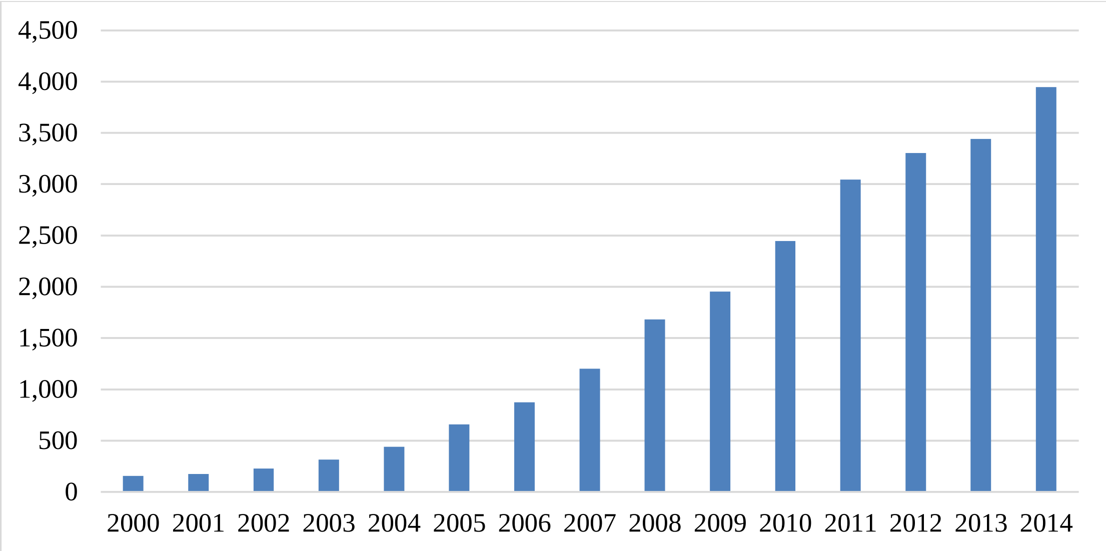
Given the CLG administration's dominance by past and current PBOC officials, there was little surprise when the CLG decided to restructure the banks in a manner favourable to the central bank. In December 2003, the CLG decided to make the PBOC a major shareholder of the state-owned commercial banks. Before the plan could be executed, a shell company had to be established to bypass a Chinese law that prohibited PBOC from owning any commercial banks. This was the genesis of the Central Huijin Investment Corporation (Huijin), a holding company set up as a 'zhongyang' corporation, signifying it was not independent, but firmly embedded within a central ministry (Liew and He, 2013: 32). Huijin was not given its own offices, but was located within SAFE. Its CEO was Guo Shuqing, who was concurrently a deputy governor of PBOC and Head of SAFE. Five of its seven directors and two of three members on its board of supervisors were from SAFE or PBOC (Ming, 2004: 3).

SAFE capitalised Huijin with $45bn of FX reserves (Sekine, 2009). This was then channelled as equity to the BOC and CCB, two of the four state-owned banks that needed recapitalisation. MOF wrote down its investments in these banks, making Huijin the sole owner. SAFE transferred additional foreign exchange reserves to Huijin as equity and a year later, Huijin bought an 8 per cent stake ($3bn) in the Bank of Commerce, followed in 2005 by a $15bn investment in another of the four SOCBs, the ICBC, making it an equal shareholder with MOF (Liew and He, 2013: 32). Consequently, the recapitalisation of these banks through Huijin had increased PBOC's influence over the banking sector at the MOF's expense. In effect, Huijin was China's first de facto sovereign wealth fund, although China resisted that label (Eaton and Ming, 2010). It was a quasi-development SWF, established with surplus reserves specifically to recapitalise the SOCBs.

2005-2007: Pressure to establish an official sovereign fund

But larger forces were at work that quickly revealed the inadequacy of Huijin as a satisfactory response to China's ongoing, rapid accumulation of reserves. In 2005, there was a massive jump in China's annual net exports, from 6 to 24.1 per cent of GDP, and a concomitant spike in US dollar holdings, captured in Table X below. This influx of USD raised pressure for yuan appreciation as these vast sums of foreign reserves could not be used for bank recapitalisation alone. That same year, China formally discontinued pegging the yuan against the US dollar and announced the yuan would be pegged against a basket of currencies. Over the past 5 years, the US dollar had depreciated 31 per cent on a trade-weighted basis against the other major industrialised economies, reducing Beijing's purchasing power. The depegging immediately appreciated the yuan by 2.1 per cent against the US dollar (Liew and He, 2013: 34–35)

Figure 2: Growth of China's FX reserves (USD bn) 2000-2014



Source: SAFE website (2014)

There was disagreement among the major economic players—the MOF, the PBOC and other parts of the bureaucracy—on whether to rapidly appreciate the yuan. The PBOC had a unique perspective. As owner of the state-owned banks through Huijin, further yuan appreciation would lower the yuan value of the banks' substantial amount of USD denominated assets. This in turn would risk reversing the bank's now vastly improved capital ratios. The PBOC was also weary of any move that would erode the value of its enormous and growing stock of foreign currency assets as that would render it dependent on a capital injection from the MOF.

Discussions regarding the need to purchase assets abroad intensified. Offshore investments would help spend and de-accumulate the stock of FX reserves and could in turn lower the pressure for yuan appreciation. But to invest foreign exchange reserves overseas and/or in non-finance sectors meant the PBOC going well beyond its central bank remit. Concern was growing within China's bureaucracy over the PBOC's inherently conflicting dual role as both bank shareholder (through Huijin) and national policymaker and regulator of the banking system.

The dispute climaxed during the Central Financial Working Conference in January 2007, where the MOF proposed two solutions: that the new Financial Assets Commission within the finance department should take over the ownership and management rights of state-owned financial assets from Huijin and that a new independent sovereign fund should be created on the basis that SAFE lacked the skills to make diversified, higher risk investments (Eaton and Ming, 2010). They also argued for the transfer of Huijin Investments to this new entity in the event the MOF could not assume control. Since Huijin was restricted in the type of investments it could make, a new structure was needed to allow greater investment choice. Both proposals 'were a direct affront to PBOC' (Koch-Weser and Haacke, 2013: 15).

SAFE and PBOC resisted these calls, not wanting to lose control over the large pot of reserves. SAFE lobbied for a mandate expansion to Huijin or the creation of a similar entity under the remit of one of its international subsidiaries to implement this offshore investment strategy. To prove it was up to the task, in early 2007, SAFE allocated up to 15 per cent of its reserves to higher-return, non-debt assets (SWC 2014). Through its Hong Kong subsidiary, it took small equity positions in some of the world's largest public companies. By mid-2007, it had disclosed holdings of up to $22.1bn in FTSE 100 companies, equalling 0.75 per cent of the index's total market capitalisation. These investments mark the beginning of SAFE's investment portfolio, borne out of intense rivalry yet lacking a sound investment mandate and strategy.

6.2 The establishment and evolution of CIC

In the end, SAFE's efforts were unsuccessful. The National Finance Work Meeting decided to create a new sovereign fund, the Chinese Investment Corporation, (CIC) officially established in September 2007. Although MOF was not made outright owner of CIC, it was given managerial control over the fund and its officials dominated the senior leadership ranks of CIC, as they still do today (See Table 3 below). Although CIC's articles of association mandated that five major government agencies—including the PBOC and SAFE—could nominate one nonexecutive director to CIC's board of directors as a placatory measure, the inaugural chairmen of CIC's board of directors and board of supervisors were both former MOF top officials and remained in this position from 2007–13 (Koch-Weser and Haacke, 2013: 17).

In a further blow to SAFE, the PBOC was compelled to sell Huijin to CIC in the fall of 2007 at a discounted price of $67bn. This ensured the government retained its stake in the state banks but avoided a controversial decision about whether to hand them to either PBOC or MOF (Eaton and Ming, 2010). Some scholars have interpreted the placement of domestic banking assets within CIC as boosting the MOF's potential influence over monetary policy. By 2010, CIC's long-term equity investments in domestic banks accounted for over half of its total assets, helping to offset losses in the fund's international portfolio suffered as a result of the global financial crisis (Koch-Weser and Haacke, 2013: 17).

However, the CIC's creation did not constitute a total defeat for SAFE. Since the central bank would not agree to relinquish control over the management of the country's foreign exchange reserves to the MOF, the CIC was placed directly under the control of the State Council as a compromise with neither PBOC nor MOF having ownership rights.

Table 3: Current CIC board members

CIC Position	Name	Current/former roles outside CIC	Allegiance
BOARD OF DIRECTORS			
Chairman and CEO	Ding Xuedong	Former Deputy Secretary General of the State Council; former Vice Minister of Finance	MOF
Vice Chairman, President and CIO	Li Keping	Former Vice Chairman, National Council for the Social Security Fund	MOF
Independent Director	Zhang Xiaoqiang	Former Vice Chairman, NDRC[9]; Former Director General at the State Planning Commission	MOF
Non-executive Directors	Hiu Zucai	Current Vice Chairman, NDRC	MOF
	Wang Baoan	Current Vice Minister of Finance	MOF
	Zhang Xiangchen	Current Assistant Minister in Ministry of Commerce	MOF
	Hu Xiaolian	Current Deputy Governor, PBOC	PBOC
	Fang Shangpu	Current Deputy Administer, SAFE	PBOC
Employee Director	Li Xin	Former Deputy Director, Commission for Science, Technology and Industry for National Defense; division chief at the Ministry of Finance	MOF
TOTAL:	**9 Directors**		
BOARD OF SUPERVISORS			
Chairman of Board of Supervisors	Li Xiaopeng	Former Vice President of ICBC	MOF
Supervisors	Dong Dasheng	Current Deputy Auditor General, National Audit Office	-
	Zhou Mubing	Current Vice Chairman, China Banking Regulatory Commission	PBOC
	Zhuang Xinyi	Current Vice Chairman, China Securities Regulatory Commission	PBOC
Employee Supervisor	Cui Guangqing	Former Director General, Information and Postal Audit Office, of the National Audit Office	-
TOTAL	**5 Directors**		

Sources: **Koch-Weser and Haacke (2013) updated with *CIC Annual Report* 2013**

Moreover, CIC was not given a stable, funding mechanism nor was it created with unencumbered equity. Instead, the MOF was forced to issue 1.55 trillion yuan in government bonds underwritten by the state-owned Agricultural Bank of China to purchase $200 billion in foreign reserves from PBOC for injection into CIC as registered equity capital. This amounted to just 15 per cent of China's total reserves in

[9] The NDRC was an ally of the MOF through much of the rivalry that preceded the establishment of the CIC. See Liew and He 2013, 35-36.

2007 (Koch-Weser and Haacke, 2013: 17). The fact that CIC's initial seed capital took the form of a loan also helped signal that the MOF was not the legal owner of CIC. Since then, CIC has only received two capital injections from its rival SAFE: $30bn in 2011 and $19bn in 2012 (SAFE, 2013: 8). This erratic funding arrangement has been publicly criticized by CIC's senior leadership, who've lamented the lack of a 'clear funding mechanism just like what other, more mature funds have' (Wall Street Journal, 2012).

In 2011, following international concern over the implications of CIC's domestic bank ownership (Sekine, 2009: 9; Li, 2012), CIC formalised the separation of CIC International, responsible for managing the fund's global portfolio, and Central Huijin Investment, which retained holdings in China's main financial institutions. Huijin remained under the control of CIC due to fears that the MOF and PBOC would once again compete its control if split off entirely (Koch-Weser and Haacke, 2013: 19). While CIC International and Central Huijin have separate boards of directors, boards of supervisors and investment managers and CIC argues that the two entities operate with a strict 'operational firewall' between them (SAFE, 2013: 8), both remain under the control of CIC's Chairman Ding Xuedong (Koch-Weser and Haacke, 2013: 19).

Despite the efforts of China's leadership to create a compromise solution in the form of CIC, SAFE has competed rather than collaborated with CIC from the outset (Wright, 2008) while CIC's main governance reforms have been driven by this rivalry. As Liew and He (2013) observe:

> 'The CIC as it stands today is largely a product of the ongoing competition between two of China's key policymaking bodies over which one of them should manage and control the country's sovereign wealth. The contest over the CIC, between China's central bank, the People's Bank of China … and the Ministry of Finance … is derivative of the larger battle between them for influence over broad economic policy and control of the country's financial assets.' (26)

7 China's exceptionalism: comparing SAFE-IP and CIC to peer funds

Armed with an understanding of how China's multi-fund approach to managing surplus reserves emerged, this section now discusses the other aspects of China's sovereign investment institutions. This section compares key aspects of the design, governance and operation of SAFE-IP and CIC to their institutional peer funds, identified in Table 1 above. Recall that SAFE-IP is a central bank investment portfolio and accordingly comes from the same family of funds as the HKMA Exchange Fund, Botswana Pula Fund and SAMA Investment Portfolio, while CIC is a reserve incorporation corporation, a category of SWF also populated Singapore's GIC and Korea's KIC. Due to space constraints and also the desirability of comparing China's approach to that of regional peers from Asia with which it might be expected to share more in common institutionally and economically, the comparison is limited to the Asian funds only: HKMA-EF, GIC and KIC. The discussion reveals that not only is China an outlier in terms of its use of a multi-fund regime for managing sovereign wealth, but also in terms of the institutional design and governance of its sovereign investment vehicles relative to its peers.

7.1 SAFE-IP and HKMA Exchange Fund

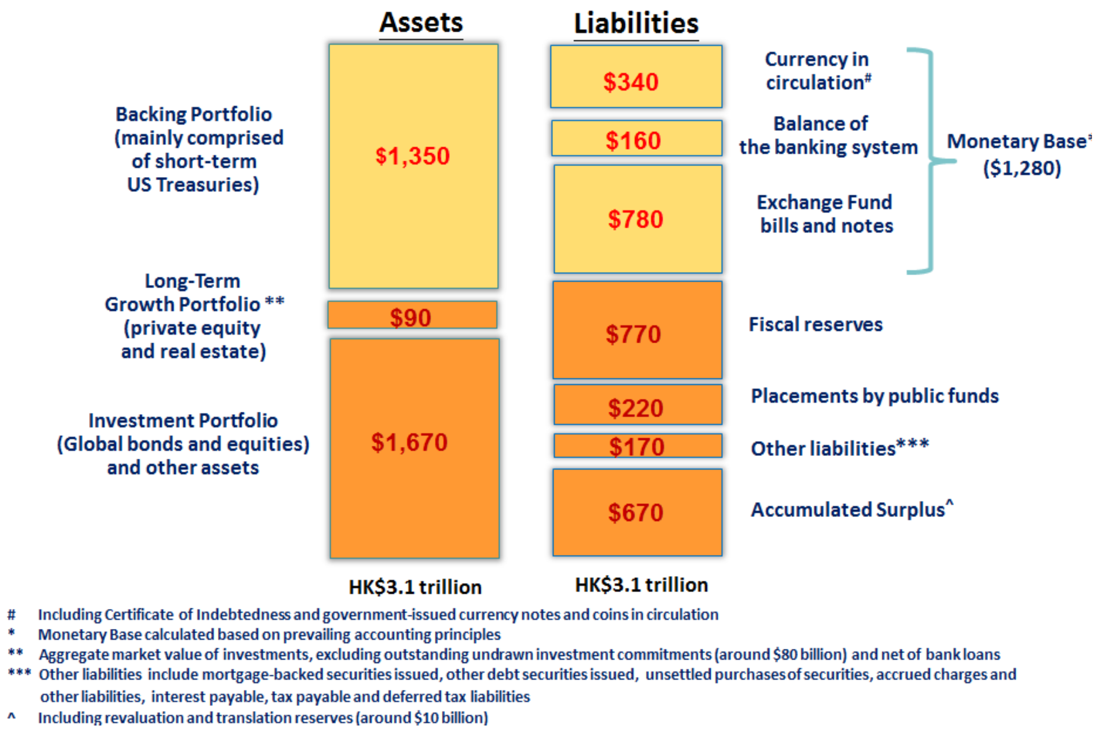
China is one of a very small number of countries to establish, either formally or informally, an investment portfolio within their central bank. The only other trade-based surplus reserve nation to do so instead of setting up a separate reserve investment corporation is Hong Kong. This makes China the only country in Asia to manage its reserves across both a CBIP and a reserve investment corporation. It is also notable that while CIC is relatively transparent regarding its investment behaviour, strategies and governance arrangements, where the SAFE is extremely opaque. While SAFE's behaviour seems at odds to that of CIC's, the question is whether it is in keeping with the practices of other peer CBIPs.

Of the small group that have such portfolios, the Bank of Botswana and the HKMA stand out in terms of the adopting a rule-based, transparent approach to the management of their surplus reserves within the central bank. Saudi Arabia on the other hand, is similarly non-transparent to SAFE. However, currently there are moves afoot to debate the establishment of an independent, transparent, rule-governed sovereign fund in Saudi. China has already undertaken this step which begs the question, what is the role of SAFE and who should be its role model? We try to answer this question by examining the economic and institutional arrangements look like when compared with its regional peer?

Background

The HKMA is Hong Kong's central banking institution, managing the Exchange Fund, one of the largest official reserves in the world. Hong Kong's total reserves as at December 2013 totalled $311 billion, the 9th largest reserves globally (IMF IFS 2014). As Table 4 below shows, the Exchange Fund is divided into three sections: the Backing Portfolio, Investment Portfolio (since 1998) and Long-term Growth Portfolio (since 2007). The Investment Portfolio holds excess reserves and is tasked with seeking higher returns than the Backing Portfolio, which may only hold USD denominated securities and pursue traditional reserve management strategies. The Long-term Growth Portfolio is a small tranche of assets held in private equity and real estate. For our purposes, we would consider both the Investment Portfolio and the Long-term Growth Portfolio as constituting HKMA's CBIP.

Table 4: Breakdown of HKMA Exchange Fund assets



Source: Chan (2014)

Funding and withdrawal

The HKMA has a rule-based, stable funding mechanism for its investment portfolio that forms part of the overall framework for managing the Exchange Fund. In contrast, there is no official confirmation or clarity around what portion of SAFE's reserves is allocated to its investment tranche, or whether there are regular capital injections. This stands in stark contrast to the fact that at HKMA, each portfolio has a set of rules and practices that govern its funding, withdrawal and investment strategy.

(a) Excess reserves: Since 2000, HKMA's Investment Portfolio has received funding according to a transfer rule approved by the Financial Secretary:

- when the Backing Ratio reaches 112.5 per cent (the upper trigger point), assets will be transferred out of the Backing Portfolio to the Investment Portfolio of the Exchange Fund assets to reduce the ratio to 110 per cent
- conversely, should the ratio drop to 105 per cent (the lower trigger point), assets will be injected from the Investment Portfolio to restore it to 107.5 per cent.

As is evident in Table X above, the HK$1.35trn in the Backing Portfolio exceeds 100 per cent of the value of the monetary base (HK$1.28trn).

(b) Fiscal surpluses: since 1976, the Government has placed the bulk of its fiscal surpluses from the government's General Revenue Account with the

Exchange Fund in return for interest income. This transfer seems to take place according to a broad consensus that all fiscal surpluses should be placed in HKMA's hands. This arrangement was introduced to avoid fiscal reserves having to bear exchange risks as part of the Linked Exchange Rate, to allow surpluses to be invested prudently and to bolster the Exchange Fund's assets to allow it to perform its statutory functions more effectively. Accordingly, all resources available to regulate the exchange value of the Hong Kong dollar are centralised in the Exchange Fund. As Table 4 above shows, the combined proportion of Exchange Fund assets dedicated to generating returns and ensuring liquidity is roughly 57 per cent.

(c) **Investment income**: this is returned to the fund to form part of the accumulated surplus.

The Long-Term portfolio does not have explicit funding rules, but rather a maximum allocation. Its assets are capped at one-third of the accumulated surplus of the Exchange Fund, the part of the fund that is effectively liability free since it constitutes the fund's own capital. The accumulated surplus of the fund represents the Exchange Fund's investment gains gradually built up over the years, which stood at HK$660 billion at the end of 2013. As evident in Table 4 above, the HKMA has not yet hit the one-third cap of approximately HK$220 billion, having committed around HK$170bn to this portfolio to date. As its name implies, the Long-Term Growth portfolio can hold less liquid, higher risk assets that promise better yields over the medium to long-term since it is financed by the Exchange Fund's own capital. To this end, it has invested in private equity and real estate assets.

On the liabilities side, the Exchange Fund has three main obligations (Chan, 2014):

(1) **Monetary base met by the Backing Portfolio**: this portfolio must be constantly liquid to meet any shortfalls in the financial system. It also has specific short-term liabilities insofar as a substantial portion of this portfolio—HK$780—flowed into Hong Kong following the collapse of Lehman Brothers in 2008.

(2) **Government deficit met by the Investment Portfolio**: this portfolio is subject to periodic withdrawals according to the transfer rule that ensures the backing ratio between the monetary base and the assets in the Backing Portfolio is maintained. It is also subject to withdrawals by the government in times of deficit since a large part of its assets are fiscal reserves and other public sector capital placed with the HKMA for investment management. As at end 2013, the government had HK$770bn in fiscal surpluses stockpiled in the Exchange Fund. Other public agencies, including the Research Endowment Fund, the Community Care Fund and the Samaritan Fund have transferred some of their not immediately needed funds totalling up to HK$220 billion. These assets could be drawn down by the government or depositing agencies at any time, and especially during budget deficits, as they were during four fiscal years between 2000 and 2004. In addition, the Exchange Fund provides guaranteed returns for the fiscal reserves, which means that under no circumstances would the fiscal reserves receive negative interest income or return.

(3) **Exchange rate**: all of the Exchange Fund's assets are ultimately available to support the Hong Dollar exchange rate.

Compared to SAFE-IP, the HKMA Exchange Fund investment tranche (consisting of both the Investment Portfolio and Long-Term Growth Portfolio) is far more transparent with official assets under management declared and with a rule-based approach to funding and withdrawals. The objective of each portfolio within the Exchange Fund is clear and this has allowed alignment of each portfolio's investment strategy with their institutional mission.

Governance and oversight
Investment decision-making for all three portfolios occurs within the wider governance and oversight procedures for the Exchange Fund. HKMA is under the direct control of the Financial Secretary. The Chief Executive of the HKMA reports directly to the Financial Secretary and is required to appear three times a year before the Legislative Council's Panel of Financial Affairs to answer questions on the Monetary Authority and Exchange Fund. A number of advisory committees provide guidance on the HKMA's work. The most important of these is the Exchange Fund Advisory Committee (EFAC), which, together with its sub-committees, carries out many of the functions of a management board. The EFAC is a 15-member committee, chaired by the Financial Secretary as ex officio Chairman. Committee members are appointed by the Financial Secretary for their expertise in finance, economics and investment. An Investment Sub-committee assists EFAC by making recommendations on the Exchange Fund's investment policy and strategy, risk management, benchmark and other investment matters, including the Investment Portfolio. EFAC then advises the Financial Secretary on investment policies and strategies for the Fund and on projects, such as the development of financial infrastructure, that are charged to HKMA. There is no indication that any of the three portfolios are subject to a separate governance framework.

While the HKMA's governance arrangements are far from perfect,[10] the stream-lined arrangements centralized around the EFAC committee are more accountable and transparent than that of SAFE's complex organisational structure with multiple branches reporting to different authorities that some have argued is designed to obfuscate (Eaton and Ming). The appointment mechanisms of both HKMA and SAFE are similarly politicized with control over both centred in elite levels of the state. However, the existence of a 15-person committee whose members largely come from the private sector rather than the bureaucracy ensures more diversity and independence in the HKMA decision-making apparatus. The requirement for the Chief Executive to report three times annually to the Legislative Council also offers a higher degree of scrutiny than SAFE is currently required to undergo. When compared to its regional peer in Hong Kong then, the SAFE-IP emerges as an unaccountable, opaque and politically managed CBIP whose investment objectives, philosophy and behaviour remain largely unknown.

7.2 CIC and the Asian reserve investment corporations

[10] It has suffered attacks of politicisation.

We now turn to the CIC to measure how it compares to its institutional peers, both of whom hail from the Asian region - Singapore's GIC and South Korea's KIC. Here we find that where the CIC is once again an outlier when compared to its more mature counterpart, the GIC, it does share some features in common with the KIC, although even then, it is distinguishable in a number of crucial respects.

Background

The GIC was set up in 1981 by then Deputy Prime Minister and Chairman of the Monetary Authority of Singapore (MAS) Dr Goh Keng Swee, who identified the need for an entity dedicated to investing Singapore's vast and growing reserves for better long-term returns. In contrast to the territoriality and extreme possessiveness over China's reserves displayed by the PBOC and SAFE, Singapore's monetary authority led the charge for a new entity to help protect the value of Singapore's domestic savings against inflation and boost returns on FX reserves. The GIC does not disclose its total assets on the basis that revealing GIC's AUM will, together with publishing the assets of MAS and Temasek, amount to publishing the full size of Singapore's financial reserves, which the government considers against the national interest. It is estimated to have $315bn under management (SWC 2014) and mandated to achieve a reasonable risk-adjusted rate of return above global inflation over a 20-year investment horizon. As Figure 3 below shows, it occupies a clear position in the middle of the risk spectrum of Singapore's sovereign investment entities with the MAS mandated to be conservative and short-term in its investment outlook; Temasek mandated to maximise shareholder value over the long term through a higher risk appetite; and GIC pursuing a moderately risk-hungry portfolio with a more globally diversified portfolio than MAS.

Figure 3: Risk spectrum of Singapore's reserves management agencies

MAS		*GIC*		*Temasek*
	→		→	
Low risk appetite		Moderate risk appetite		High risk appetite

The KIC on the other hand shares more in common with the CIC in terms of origin. It is one of several sovereign funds set up to manage excess reserves accumulated in the wake of the Asian financial crisis. Its creation was part of a broader effort to revive and strengthen the South Korean financial sector. Similar to China, there was substantial competition for its location with the Bank of Korea publishing a series of papers first, arguing against the need for any additional diversification of reserves and subsequently, conceding there was a need, but calling for a new entity to be placed within the BOK (Kalb, 2014). It is an unusual sovereign fund insofar as it has a broad, dual mandate to both generate returns on its reserves investment (but not for any specified policy purpose) and to develop its domestic financial sector by mandating local asset managers.

Funding and withdrawals
Both the GIC and KIC are more rule-governed in terms of their savings (transfers) and spending (withdrawals) rules. Of the two reserve investment corporations, only GIC has a stable funding mechanism. The GIC is funded by an annual contribution from the government financed by balance of payment surpluses and accumulated national savings. The size of the contribution is at the government's discretion. GIC does not own this injected capital, but instead manages these assets on behalf of its client, the government of Singapore. While the annual capital injections increase the overall portfolio size of the GIC, they are not calculated as part of the fund's investment returns. This also means that GIC's funding has the backing of Singapore large foreign exchange reserves.

The GIC has liabilities to the Singapore Government through a programme called the Net Investment Returns Contribution (NIRC) that requires GIC, MAS and Temasek to supplement the annual Budget with a portion of their annual investment returns. The NIRC comprises up to 50 per cent of the net investment returns on the net assets managed by GIC and MAS. In 2012, this amounted to roughly 15 per cent of Singapore's total budget. The Singapore Constitution permits the government to utilise up to 50 per cent of Net Investment Return contributed to the budget each year, resulting in some portion of the returns being saved for future budgets. The portion that the government uses has typically been allocated to long-term investments in things like education, healthcare, environment and R&D.

In addition, Singapore's Constitution protects Past Reserves. Past Reserves refers to the reserves accumulated during previous terms of Government. To prevent reckless spending by a government that could result in a drawdown of Past Reserves, the Constitution protects the Past Reserves of the Government and Fifth Schedule entities, including GIC and Temasek. The reserves of each entity are separately protected for clear accountability.

The KIC funding and withdrawal framework is not quite as regulated as GIC, but is still somewhat rule-governed. The organisation's establishing bill, the KIC Act 2005, required that the fund be established with foreign exchange which were to be entrusted to it from a variety of government sources including rival organisations –the BOK and the then Ministry of Finance and Strategy (MOF). As per the Act, in June 2006, the BOK provided the first capital injection, entrusting $17 bn (KRW1 trillion Won), required by the KIC Act. A few months later the MOF transferred $3bn from its Foreign Exchange Stabilisation Fund, followed by a subsequent transfer of $10 billion in November 2007, making the KIC a sizable fund in terms of start up capital (See Table 5 below). Since that time, there have been additional transfers of capital by both entrusting sponsors, but there is no stable funding mechanism. Compared to CIC however, the initial funding arrangements more effectively managed the rivalry between Korea's central bank and finance ministry through the requirement that both rival entities were to inject capital into the new, independent reserve incorporation. Like the CIC, KIC also has not explicit liabilities

Table 5: History of KIC funding tranches

Date of transfer	Source	Amount

June 2006	Bank of Korea (BOK)	$17 billion
October 2006	Ministry of Finance and Economy (MOF)	$3 billion
November 2007	Ministry of Finance and Economy (MOF)	$10 billion
Total initial entrusted assets (End 2007)		**$30 billion**

Source: KIC website

Internal governance and oversight

This attempt to defuse rivalry within Korea's bureaucracy through equal treatment also occurred in the governance arrangements. The KIC's highest governing body is the steering committee, made up of nine members including KIC's CEO, the Finance Minister and the Governor of the Bank of Korea as representatives of the entrusting institutions and six South Korean private sector professionals from finance, academia and major corporates. The steering committee acts as a supervisory board and is meant to ensure 'arms-length' operation from the government, although the government is represented on the committee through the Finance Minister. This broad public and private sector representation represents a far more diverse and balanced board composition than that of the CIC, which is 100 per cent comprised of bureaucrats.

The CEO of KIC is appointed by the President of the Republic of Korea following recommendation by the Finance Minister who is in turn advised by the President Recommendation Committee and the Steering Committee. A new CEO was appointed in December 2013, the fifth Chief Executive the KIC has had since its inception only 7 years ago. This particular aspect of KIC's governance is flawed as the high turnover of CEOs reflects extensive politicization.

Day-to-day operations of KIC are overseen by a four person Board of Directors, consisting of the CEO and three Directors, chosen from within the ranks of KIC's senior management. Directors are appointed (and dismissed) by the CEO, who chairs Board meetings, following the Steering Committee's review. Two sub-committees—the Investment Steering Committee and the Risk Management Committee—assist the steering committee on investment and risk policy. Each sub-committee has four members. KIC's CEO sits on both the Investment and Risk Management sub-committees along with three independent Steering Committee members, one of whom is on both sub-committees. Neither the Minister of Finance nor the Governor of the Bank of Korea is on either sub-committee.

Along with Kuwait's KIA and Norway's GPFG, the KIA is one of the world's few large funds structured to allow direct public scrutiny of its behaviour. It is required by law to disclose financial statements, audit reports, total assets under management (AUM) and more unusually mid- and long-term investment policies, asset mix, and its return on total AUM. This information is all publicly available in its Annual Reports and on its websites.

GIC on the other hand, has a more political internal governance arrangements. GIC's primary governance mechanism is its 14 member Board, chaired by Singapore's

Prime Minister Lee Hsien Loong. Board members are appointed by the Ministry of Finance, representing the Government as owner, with assistance from GIC provided in sourcing qualified candidates. Under the Constitution of Singapore, the concurrence of the President of Singapore must be sought for the appointment, removal or renewal of Board members. Before the President decides on whether to concur, he obtains advice from the Council of Presidential Advisers (CPA), which in turn scrutinises the appointment. The President has discretion to decide whether or not to concur with the appointments after consulting the CPA.

The Board contains multiple members of Singapore's political elite, including the Deputy Prime Minister and Minister of Finance, Ministry for Trade and Industry, Minister for Education and Deputy Prime Minister and Minister for National Security. Founding Prime Minister of Singapore Lee Kuan Yew is a senior advisor to the GIC Board. Despite this, there have been attempts to ensure proper accountability and oversight through the use of 'double key' system for GIC's governance. A current government is only allowed to spend as much as they have accumulated in the current term. If the government needs to tap the reserves in GIC or other Fifth Schedule entities, they may apply to the President for permission to unlock the reserves. In effect, past reserves are available to the government if both the government and the President agree that the current conditions warrant them unlocking the reserves. This government 'turns their key' by making a request to this effect to the President and the President acts as ultimate guardian of the reserves in determining whether the request is legitimate. If deemed legitimate, the President will also turn his key. Recent attempts to tap GIC's reserves during the global financial crisis revealed a ambiguity on what counts as a legitimate basis for the government to request the unlocking of past reserves, or when and why the President should turn his key.

It is clear then that while GIC has highly politicised board composition and internal governance mechanisms, it has still attempted to ensure accountability, scrutiny and insulation of its assets through the novel 'double key' approach. Similarly, Korea has sought to diffuse the rivalries of its entrusting institutions and to balance their power over the KIC by creating a board of directors with broad public sector representation and independence. The CIC again seems an outlier in the extent to which its governance mechanisms are controlled by an entrusting institution and the absence of proper diversity on the board.

8 Conclusion

China is the only country in the world with two sovereign investment vehicles dedicated to managing excess foreign reserves for a return and not just liquidity. This paper sought to understand the origin of this unique approach to sovereign wealth management as well as to evaluate each vehicle through appropriate comparison to peer investors. While many studies compare the CIC and SAFE to one another, this article sought to understand how the two funds' organisational design and governance compared with similar entities internationally and regionally. It showed that China was an outlier regarding its sovereign investment landscape in three senses: first, it's exceptionalism as a multi-fund regime is attributed largely to the intense bureaucratic rivalry within China's public service. While the resistance of central banks losing monopoly control over foreign reserves is not unprecedented, China's compromise solution of having an investment portfolio within its central bank and a separate, dedicated sovereign fund sharing the task of high return-seeking on reserves is unique. This aspect of the Chinese approach to sovereign wealth management is significant insofar as this rivalry has resulted in somewhat reactive, competitive investment strategies in both entities making it difficult for China to defend its claim that its sovereign vehicles are mainly commercial investors. Second, relative to their regional peers in the HKMA and KIC, SAFE and CIC lack robust institutional mechanisms to achieve proper arms-length governance from their state sponsor. Indeed, analysis of known CIC and SAFE investments suggests alignment with state economic goals, undermining China's effort to advance a conception of its sovereign investors as purely returns-oriented operators. Third, in terms of fundamental design, China's sovereign investors have something to learn from their regional peers about greater clarity of mission and purpose and alignment of that mission with decision-making. But this is unlikely to take place until an overarching policy for regulating China's sovereign investor landscape is developed.

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