Testimony of David Marchick
Managing Director and Global Head of Regulatory Affairs

The Carlyle Group

before the United States Senate --

Committee on Banking, Housing, and Urban Affairs

April 24, 2008

Chairman Dodd, Ranking Member Shelby, Members of the Committee:

Let me start by complimenting the Chairman, the Ranking Member, and this Committee for your leadership on the Foreign Investment and National Security Act (FINSA). Mr. Chairman, you and Senator Shelby deserve credit for being focused on the importance of a strong national security review mechanism long before Dubai Ports brought the issue into the national spotlight.

I worked on foreign investment issues during my time in government and for the past six years before I joined Carlyle. I am speaking as much from my previous experience as from my current perspective at Carlyle.

I would like to focus on four issues in my testimony:

1. Why the focus on SWFs?

2. The many layers of laws and regulations that protect important governmental interests related to foreign investment;

3. Third, the important work on transparency being led by the Treasury and IMF;

4. The importance of maintaining an open market for foreign investment in the United States.

First, why all the focus on SWFs?

The new attention on sovereign investments can be traced to a number of factors. There has been a rapid growth in the number and size of SWFs. Much of this growth has occurred in the developing world, including China, Russia, and the Middle East, and there have been more high-profile investments from government-affiliated entities. The growth in SWFs has come at a time of overall growth in outward investment from developing nations: for example, from 2000-2006, outward FDI from China grew 6.9 times, from Russia 5.9 times, and from some Middle Eastern states more than 35 times. The last time the US saw such large increases in FDI was with Japan in the 1980s. Congress passed the Exon-Florio Amendment into law, creating a national security review process for foreign investment. While there was an uproar in the 1980s with respect to Japanese investment, today, Japanese investment is part of the fabric in large and small communities around the country.

While the number and size of SWFs has grown in the past few years due to high oil prices and growing current account surpluses, sovereign wealth fund investments represent a small slice of the global investment market: in 2007, the value of SWF mergers and acquisitions (M&A) activity represented only 1.6 percent of total global M&A volume. The percentage may be larger in 2008, but overall will still represent a small component of global investment.

Sovereign wealth funds have a lot of money - $3.2 trillion according to some estimates – but are tiny compared to the $52 trillion in global pension and mutual funds. Further, while there have been a number of high profile investments, the vast majority of SWF investments are for passive, minority stakes. SWFs have, in fact, served as an important source of stability at a time of great uncertainty in financial markets.

Second, the United States has a robust, layered set of laws and regulations that protect important governmental interests associated with any investment, sovereign or otherwise. FINSA protects against threats to national security, and CFIUS has demonstrated its willingness to block or mitigate problematic investments. DOD has its own set of regulations to protect the defense supply chain and classified information. Hart-Scott-Rodino triggers antitrust reviews for any significant acquisition. And in any sensitive sector, there are a host of laws and regulators that provide additional protection. In the chemicals industry, for example, there are five federal regulators focused on safety, security, transportation and other issues; several state-level regulators; and more than a dozen federal statutes that impose various, wide-ranging controls on chemical investments and operations. The Fed, Treasury, OCC and OTS scrutinize investments in the banking sector. Similar laws and regulatory oversight exist in the telecommunications, energy, pharmaceutical, and transportation sectors, among others. Even if there were cause for concern associated with sovereign wealth funds, our existing legal and regulatory structure should capture and fix – or block – any problematic investments. Bottom line: when a foreign entity invests in the United States, the US is sovereign, not them.

Third, the United States and international community are making progress on improving transparency associated with SWFs. The Treasury's recent announcement with Singapore and Abu Dhabi was a very important step. In that agreement, two of the largest host countries for sovereign wealth funds confirmed that investment decisions should be based solely on commercial grounds, not political purposes. They also highlighted the importance of greater disclosure of financial information, including asset allocation, as well as appropriate governance and risk management systems. I would encourage this Committee to support the Treasury and IMF's efforts to improve and enhance transparency through a voluntary code of conduct.

Fourth, just as sovereign wealth funds have been asked to establish codes of conduct, countries receiving investments from sovereign wealth funds need to act responsibly as well, and the United States needs to lead the way. One can legitimately ask the question whether there is a greater risk that receiving countries will block legitimate investments for political reasons, or that a sovereign wealth fund will make an investment for political reasons.

In fact, there is cause for concern that countries are moving to tighten up rules on investment. In the last two years alone, more than a dozen countries representing more than 40% of global inward foreign direct investment have adopted or are debating new investment restrictions. There is cause for concern:

- For the first time in its history, Canada blocked a U.S. acquisition of a Canadian satellite company;
- New Zealand blocked a potential investment from Dubai in the Auckland airport.
- Australia announced stricter guidelines for foreign government investment.
- Japan blocked an investment by a European hedge fund in a power company, citing national security reasons.
- Several European countries have blocked investments from other European countries in the energy sector.
- China has tightened its rules and rejected a number of proposed investments.
- France now scrutinizes investments in 11 sectors; Russia scrutinizes investments in 43 sectors, and Germany is considering its own new foreign investment restrictions.
- And CFIUS has dramatically increased the number of reviews and the number and scope of mitigation agreements imposed on foreign investors.

If the United States is not welcoming to investment, it could contribute to a broader wave of protectionism to the detriment of U.S. investors and our economic health. As the largest source of investment in the world, we lose more than any other country if investment protectionism grows.

There is a real risk that if the regulatory and political environment in the United States creates uncertainty for investors, capital indeed will flow elsewhere. The UK, for example, has demonstrated leadership in publicly welcoming foreign investment. The Chancellor of the Exchequer Alistair Darling welcomed investment from China Investment Corporation in the UK. The CEO of Dubai International Capital -- a $13 billion investment fund -- recently said that because of the political environment in the U.S., he would prefer to pursue deals in the United Kingdom. I would much rather have the investment come to the United States than another country, but if investors think the political or regulatory risk is too high in the US, they will look elsewhere.

Let me be clear: CFIUS should block any investment that threatens U.S. national security and cannot be mitigated. Other parts of the US government should be vigilant in protecting other legitimate interests. But unless a particular investment presents a particular problem, our doors should be wide open to foreign investment.

I'd like to take a moment to explain The Carlyle Group's positive experience with two investments from government-affiliated entities. First, the California Public Employees Retirement System (CalPERS), the largest public pension fund in the world, acquired a 5.5 percent interest in Carlyle in 2000. Second, the Mubadala Development Company, a firm that invests funds on behalf of the government of Abu Dhabi, purchased a 7.5 percent stake of Carlyle in 2007. The terms of these investments are pretty simple: CalPERS and Mubadala acquired passive, limited partner stakes in Carlyle. They exercise no control or influence over our investment decisions. Their investments have allowed us to create strong U.S. companies, grow jobs and spur innovation. CalPERS and Mubadala each receive a quarterly or annual financial report, and we will work hard to produce an attractive rate of return for both entities.

Both CalPERS and Mubadala are sophisticated investors, and we are grateful for the confidence they have shown in us.

In summary, SWFs have been an important source of capital for the US and in recent months they have helped provide stability to our financial markets. The typically passive, minority nature of their investments is important to recognize, while at the same time the United States has a proven set of laws and regulations that protect our national interests associated with any foreign investment. Nonetheless, improved transparency by SWFs will provide additional information and comfort and help forestall rising protectionist sentiments. Barring a particular problem with a particular transaction, our doors should be wide open to foreign investment.

Thank you once again for the opportunity to appear before you today.