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### Leadership Changes Afoot at CIC

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As we write this, the executive leadership of the China Investment Corporation is in flux. Its inaugural Chairman, Lou Jiwei, has just stepped away from the CIC to lead the Ministry of Finance, and despite several reports placing Guo Shuqing, head of the China Securities Regulatory Commission and former Chairman of China Construction Bank, in the Chairmanship of the CIC, he was recently appointed to be Deputy Party Secretary of Shandong Province.<sup>2</sup> Although several other individuals with executive experience in international finance and banking have been mentioned for the position, including Li Jiange, Chairman of China International Capital Corp, and Jiang Jianqing, Chairman of ICBC, to date, no appointment has been made. While it is not really our intent here to try to forecast Chinese leadership appointments, given that a new Chairman may be appointed imminently, we do aim to suggest a view on some challenges the new Chairman is likely to face and the qualifications we believe will be required to navigate them successfully.

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<sup>2</sup> See "Chief Regulator Guo Shuqing Tipped as Shandong Governor", [South China Morning Post](http://www.scmp.com/news/china/article/1189477/chief-securities-regulator-guo-shuqing-tipped-shandong-governor), 13 Mar 2013 accessed <http://www.scmp.com/news/china/article/1189477/chief-securities-regulator-guo-shuqing-tipped-shandong-governor>. This appointment is somewhat curious considering Guo's expertise, although there are precedents – Dai Xianglong, a former governor of the People's Bank of China went on to become mayor of Tianjin – and Guo's own experience includes a stint as vice governor of Guizhou Province. Not directly germane to the remainder of this note, however, it is perhaps best the subject of a separate missive.

As it enters into its next half decade, the CIC today confronts a number of institutional and global financial issues that will absorb its leadership in the days and weeks ahead. The issues are by no means mutually exclusive, but rather nested, and they include:

1. **Massive size** – With nearly \$500B in asset under management, the CIC now ranks as the world's fifth largest SWF<sup>3</sup>, third if one excludes central banks. Will it soon reach a size that will render it too big to be able to invest effectively? As China continues to amass reserves, will it continue to receive state allocations of capital? Is it possible the CIC could be split up?
2. **Organizational structure** – In 2010, the CIC established CIC International in an effort to distinguish between its domestic and international mandates. As parent of Central Huijin Investment, the primary shareholder of China's State-owned Banks (SoBs), how can CIC effectively manage this dichotomous challenge?
3. **Staffing and in-house capacity** – This is the bane of most major institutional investors and is especially problematic in countries with small professional talent pools and growing institutional investment sectors. Certainly CIC remains a premier destination for China's elite investment professionals. However, it too must focus on staffing in order to effectively execute its mandates. What measures are required to prevent staff flight and strengthen its ability to attract good resources? How can it resolve the challenge of being a government entity, yet still offer globally competitive compensation?
4. **State banks holdings** - Further to point 2, lackluster stock price performance by China's SoBs have suppressed CIC's returns. Also, as shareholder of a major sector of the Chinese financial system, the CIC may find itself conflicted with respect to its own institutional priorities on matters such as compensation. What role should CIC play in bank management? Should it continue to periodically add to its positions on weakness? Going

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<sup>3</sup> See <http://www.swfinstitute.org/fund-rankings/>

forward, what impact will the performance of the banks have on CIC's overall investment performance?

**5. Low return global macro-economy** - This has become a perennial challenge for all large institutional investors. How far should the CIC proceed down the path of aggressive allocations to alternative assets?

**6. Protectionist barriers to inward investment** – The CIC continues to face protectionist investment constraints. What measures can the CIC undertake to allay concerns of recipient countries?

**7. Rivalry with SAFE** – We (and others) have documented this elsewhere,<sup>4</sup> and we believe it will continue to absorb executive time and attention at the CIC, complicating attempts at institutional reform.

To address these matters effectively, we believe that the new Chairman of the CIC must have two core sets of qualifications. The first relates directly to technical competency and managerial ability and includes both demonstrated international financial expertise and leadership. The second set of qualifications, no less important, relates to political skills and the ability to effectively navigate the halls of Zhongnanhai.

First and foremost, with the CIC ultimately reporting to the State Council, the new Chairman must have the confidence of both senior leadership within the CIC and senior state and party leadership. The Chairman should also be globally recognized and respected as one of China's top finance and banking professionals, with expertise and experience in both banking and capital markets (though that experience need not be evenly split). In short, the Chairman must have good

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<sup>4</sup> See Patrick J. Schena, "The China Investment Corporation at 4 Years: An Evolving Legacy of Capitalization and Control", accessed at <http://fletcher.tufts.edu/SWFI/~/media/Fletcher/Microsites/swfi/pdfs/2012/P%20Schena%20CIC%20Mar%20Bulletin%20Final.pdf>

international exposure, be bureaucratically astute, and politically connected to enjoy the protections needed to be successful organizationally.

As noted above, Lou Jiwei has been appointed as Minister of Finance. This appointment suggests that the CIC Chairmanship may be stepping-stone to a State Council position. If so, given the imposition of mandatory retirement at age 65, it makes sense that the new Chairman may be relatively young (mid-fifties perhaps) and ambitious – in other words, interested and potentially able to assume a ministerial post in future.

Finally, as with all things related to Chinese leadership change, we turn to the role of political strength. Lou Jiwei has been an alternate member of the Chinese Communist Party (CCP) Central Committee (CC) during his tenure at the CIC. With Guo Shuqing presumably no longer a candidate, some other names mentioned for the role include Li Jiange, Jiang Jianqing, and the current Vice-Chairman of CIC, Gao Xiqing. Of the four, Guo is the youngest and was recently appointed a full member of the CCP CC. In some respects then, he seems like he would have been the ideal choice. In contrast, neither Li or Gao are members (or even alternate members) of the CCP CC. While Jiang has been an alternate member of the CCP CC since 2002, he was not promoted to being a full member of the CCP CC this past fall, and recent reports suggest he may be in disfavor due to a more cautious, commercial approach to credit expansion he took after the global financial crisis in fall 2008.<sup>5</sup>

Looking more broadly, the Chairmen of China's three other major SoBs - Wang Hongzhang (China Construction Bank), Jiang Chaoliang (Agricultural bank of China), and Xiao Gang (Bank of China) were each appointed as alternate members of the CCP CC at the Party Congress in November 2012<sup>6</sup>, perhaps portending greater leadership roles for the three in the future. In fact, recent reports note Xiao Gang has already been appointed to succeed Guo Shuqing as head of the CSRC.

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<sup>5</sup> Lingling Wei and Bob Davis, "For a Top Chinese Banker, Profits Hinder Political Rise", *Wall Street Journal*, 18 Feb 2013

<sup>6</sup> See Xinhuanet, accessed [http://news.xinhuanet.com/english/special/18cpcnc/2012-11/14/c\\_131974821.htm](http://news.xinhuanet.com/english/special/18cpcnc/2012-11/14/c_131974821.htm)

Given past precedent and the organizational stature of the CIC Chairmanship, we expect the position will likely be filled by someone with at least alternate CC rank. If not, CIC's current Vice-Chairman, Gao Xiqing, seems like a good internal choice. Having served ably in the role of Vice-Chairman and functioned well as a global spokesman for the CIC, Gao is engaging, extremely articulate in English, and remarkably open, having been a voice against, among other things, protectionist barriers to inbound investment and most recently Japan's reflationalary policies.<sup>7</sup>

Lou Jiwei's legacy is a \$500B global institution whose actions are carefully scrutinized by governments, investors, media, and private citizens both within and outside of China. The job of the next Chairman of the CIC - whether an internal promotion or external transfer - will be to strengthen the CIC organizationally and advance its interests as a major global investor along with China's interests more generally, all while delivering superior risk-adjusted performance. This will command experienced leadership and resolve. Who will be up to that task? We should know shortly.

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<sup>7</sup> See Lingling Wei, "China Fund Warns Japan Against a 'Currency War'", Wall Street Journal, 6 March 2013