What Attorneys Must Know to Steer Sovereign Wealth Funds

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By Darcy Reddan

Sovereign wealth funds rival their private-sector counterparts in market share and are helping fuel the development of emerging industries, but their varied approach means attorneys who advise them must prepare to navigate uncharted waters.

Sovereign wealth funds, or state-owned investment funds, operate with less visibility and different goals compared to the interests of a standard investment firm — and no two sovereign wealth funds are the same, which can lead to challenges for attorneys.

Controlling roughly $7.45 trillion assets worldwide, these funds rival the size of the entire $8.7 trillion alternative assets industry, according to a special report released by Preqin in September 2018.

But despite the size of their investments, no single road map has emerged for advising these monolithic investment vehicles.

Prakash Mehta, co-leader of Akin Gump Strauss Hauer & Feld LLP's investment management practice, told Law360 there is no set course for advising these state-owned funds because no two sovereign wealth funds are alike.

The old adage about the uniqueness of family offices, "if you've met one family office then you've met one family office," also applies to sovereign wealth funds, he said.

When attorneys are advising sovereign wealth funds, they should familiarize themselves with why the fund has been set up, Mehta said, noting that among the most common purposes of these state-owned investment vehicles is to help a nation diversify from a resource-oriented economy, a strategy often employed by nations that draw their wealth from oil.

Sovereign wealth funds can be formed with a different goals in sight, however, and Mehta noted the importance in knowing the endgame before moving forward.

"The first thing to do is step back and say 'Okay, what is the sovereign wealth fund in question trying to achieve?'" Mehta said.

Attorneys need to take the time to understand the fund and its long-term goals. That includes understanding which industries the fund is interested in, whether it be investments in technology or infrastructure projects, both of which have seen an uptick in interest as of late.

Using infrastructure as an example, Mehta said that the funds are “largely sector-agnostic” and will not go out of their way to target airports or toll roads. Instead, they often look for opportunities that will provide the returns they're looking for in a particular asset class.

Once attorneys have a grasp on what a fund is trying to do, it’s time to consider some of the novel methods of achieving those goals.

A relatively new trend — bilateral partnerships between nations for the purpose of co-investments — has been cropping up around the world, according to Rachel Pether, senior advisor to the Sovereign Wealth Fund Institute.

Pether highlighted budding relationships between Saudi Arabia, Russia, China and the United Arab Emirates, noting that there has been increasing interest in infrastructure projects in other nations as well as investments in technology with the purpose of bringing new business or technology to their respective nations. In fact, Pether said there has been a surge in overbidding on infrastructure assets as countries look to solidify relationships with other nations.

“Sovereign wealth funds don’t have a defined set of liabilities. So they do have much more flexibility and creativity in what they can invest in” than other types of funds like pension funds, Pether told Law360.

When advising these state-owned funds, Pether said she believes the most important thing to keep in mind is that they often have strategic goals aside from making stable long-term investments.

Because each fund presents its own unique set of obstacles, attorneys should not be afraid to think outside the box in order to identify novel investments on behalf sovereign wealth funds.

Pether pointed out the importance of diversity of thought, saying that both the firms and the wealth funds should seek out “future gazers,” noting that leaning on younger generations or people from differing backgrounds and cultures can help find trends in their earliest stages.

While younger generations might be more in tune with developing trends in emerging industries, and diversity of ethnicity and gender can translate into a diversity of thought, those qualities must also be met with experience in steering investments.

In addition to taking a different approach to investing, Pether said these funds might have a higher risk appetite, but said advising these high-profile investments is not a walk in the park.

Noah Wortman, business development manager at litigation finance firm IMF Bentham Ltd., said that despite the higher risk threshold, sovereign wealth funds have more to consider than other types of investors.

Wortman, who focuses on global investor recoveries, noted that sovereign wealth funds have to weigh political factors such as government regulations or oversight from parliamentary or regulatory bodies, which a local union pension fund would not have to consider.

For example, the October 2018 disappearance and murder of Washington Post reporter Jamal Khashoggi in Saudi Arabia has hurt investments in the country’s Public Investment Fund of Saudi Arabia, Pether said.

And although controversy at home might affect investments, Wortman said sovereign wealth funds tend to be more sophisticated than smaller institutional investors when it comes to handling litigation around their portfolio/assets.

He noted that although state-owned funds might be more sophisticated, the other side of that coin is that they are also more cautious in joining litigation to recoup losses on an investment that goes south.

“They’re going to take a wait-and-see approach because they realize how big their stake and exposure might be in a given case and what the ripple effect might be of them joining a case,” Wortman said, noting that sovereign wealth funds are not going to be the first ones to stick their head above the parapet or ignite a lawsuit.

Wortman said these funds recognize that their size and stature creates a leadership position, acting as a barometer to other institutional investors.

This position leads them to be more cautious when determining when to engage in shareholder litigation, resulting in a more secretive approach to assessing their investments.

“It’s a bigger animal, more complex animal, and a more conservative animal generally,” Wortman said.

--Editing by Rebecca Flanagan.