

From Term Taker to Deal Shaper

The evolution of the sovereign wealth fund and asset manager relationship – an analysis by Ayman Khaleq and Aaron Suh of Morgan Lewis.

As recently as a decade ago, most global sovereign wealth funds (SWF) sought to invest in investment funds managed by global asset managers with a view to preserving and growing the wealth of their nations, often through adopting relatively conservative investment strategies and negotiation approaches. As such, they were one of many institutional investors in a private equity or hedge fund, with the ultimate discretion and decision-making on investment opportunities and fund governance resting with the asset manager. That is dramatically changing; now several SWFs are making bolder moves to seek out investments that also allow them to, among other things, invest more strategically as well as acquire and transfer technology back to, and create employment opportunities in, their respective economies. This has resulted in them taking or participating in a driving role in shaping those investments. Asset managers are viewing this shift as a way to get deals done

in a challenging capital-raising market.

This power dynamic shift is causing a shake-up in the market. Many SWFs are originating deals with new contacts, with many deals coming to fruition through direct negotiations through just a few head executives. Others have also started investing with relatively smaller fund and asset managers as they focus on broadening their reach within developed markets and seeking exposure to emerging markets in sectors such as technology, financial institutions, infrastructure, healthcare, automotive and sports. Those investments are looking for a larger swing of growth and go beyond the preserving wealth ethos. They also provide less opportunities for the major investment banks that previously had been the primary deal originators and executors for SWF.

FUNDS OF ONE AND SEPARATELY-MANAGED ACCOUNTS (SMAs)

There is also a new trend toward multi-asset manager platforms, which is a marked shift from the more traditional model of an asset manager attracting multiple investments into a fund, of which SWF are just one of many. In the multi-asset manager platform, the roles are effectively reversed, whereby the SWF creates the platform and seeks out multiple asset managers to deploy capital within specific asset classes. Even in cases when a single manager manages a fund-of-one or SMAs for a SWF, the balance shifts in favour of the SWF in terms of economics, fees and expenses, and governance, among other aspects. In many ways, this format streamlines some of the due diligence of dealmaking as the SWF provides the capital (and there is no time needed for a capital raise) and investment strategies and parameters are already defined and agreed on by asset managers, which leads to a much lighter



due diligence process between the asset manager and SWF for each deal. In addition to making the actual process of investing a bit smoother for both the SWF and asset manager, SWFs are finding an added benefit from the brain trust the asset managers bring to a deal, which they would have had access to if they find themselves having to organically build an investment team to directly execute those deals that they elect to invest in.

This setup is increasing the number of asset managers interacting with SWFs, as SWFs investing in their home countries are attracting the expertise of global asset managers; often through strategic collaborations or even project-specific partnerships with those asset managers, while enticing them to set up in those jurisdictions through rebates or enticing investments. In parallel, local private asset managers and management teams (through “seed and stake” arrangements) are receiving equity injections of funding from SWFs in different areas of the world. Moreover, local or regional asset managers owned by governmental entities (including SWFs) are also a conduit to invest with or in funds managed by global asset managers. We have seen them acquire stakes in, or enter into strategic alliances with, global asset managers, to gain (and give their private banking clients and locally-managed funds) exposure to a particular asset class or strategy.

DIRECT INVESTMENTS AND DEAL ORIENTATION AND UNDERWRITING

This multi-asset manager platform is allowing for the acceleration and expansion of SWF’s strategies to take a larger role in deal origination. Instead of waiting on US or EU asset managers to source deals and invite them to join, many SWFs are taking that lead role on everything from leading venture capital rounds to investing in relationships with CEOs and company founders to find their own seat at the table. Many are now including these moves and relationships as part of their own marketing materials, putting even more emphasis on the importance of this power dynamic change.

In addition to the targets of investments changing, we are also seeing the types of SWF investments evolve. Increasingly, SWF funds are requiring a minimum quantity of co-investment opportunities in conjunction

with fund investments, and SWF funds are also pursuing their own direct investments in a lead role, with the structure of the investments aligning with the evolving vision of the government from which the SWF originates. There is a stronger focus on the educational opportunity that a closer-in investment role can provide, creating employment opportunities for a growing young population, and establishing the company as a global player, which sometimes drives an investment decision.

There are a few main types of co-investor participation levels. The first, and most significant, is if SWF is acting as co-underwriter with a lead sponsor or acting as their own underwriter, which means they are brought on before the deal is signed and usually given the largest allocation of the deal. The SWF also negotiates deal points that are important to it, including the consortium document that will define the relationship between the investors. Seeing SWFs move from term takers that are just getting invited to the table without much real say to now shaping the deals is a signal of how this market may continue to evolve, especially in a high interest rate environment where alternative capital solutions are sought more willingly.

There is a dearth of capital coming from other sources as regulatory boundaries created from national security, antitrust, geopolitical situations make it trickier to source new funds. SWFs are becoming more and more relevant for investors and are viewed by many as a significant part of what is keeping the deal environment going in this market. It should be noted, however, that this needs to be analysed against a challenging regulatory environment, that impacts such considerations as national security, financial regulatory and international trade, among others. 🇺🇸

“There is also a new trend toward multi-asset manager platforms, which is a marked shift from the more traditional model of an asset manager attracting multiple investments into a fund, of which SWF are just one of many.”



Text by:
1. AYMAN KHALEQ, partner, Morgan Lewis
2. AARON SUH, partner, Morgan Lewis