

## Key Takeaways

Baker McKenzie recently hosted the **International Forum of Sovereign Wealth Funds (IFSWF) General Counsel Summit**. This was the first opportunity in since 2019 for GCs, compliance and tax managers from SWFs globally to gather in person under the IFSWF banner. Over 100 delegates engaged in lively and fruitful discussions over two days on topics ranging across investments, tech, AI, crisis management and disputes.

We have summarised the key themes discussed during the Summit in this overview.

Special thanks go to our many SWF panellists and external guest speakers who facilitated and contributed to the debate; and, not least, to **Duncan Bonfield** and **Victoria Barbary** of the **IFSWF** for their invaluable partnership in organising the Summit. If you would like further information on any of the topics covered, please reach out to one of the Baker McKenzie contacts listed at the end of this bulletin.

### ► Legal Function and AI

#### Developments in Legal Tech & AI - Impact on the Legal Ecosystem

There was a far-reaching examination of the role and potential of legal tech in the SWF legal function. The panel discussed how the legal function can manage risk complexity in an era when legal tech offers lawyers the potential to handle more information and increase productivity in the face of greater complexity. Private equity sponsors have begun trialling AI to deal with M&A documents - these models are adapting and showing signs of improving efficiency in the longer term.

Tools such as ChatGPT and language models may lead to a breakthrough – we are already seeing promise within areas such as ESG – and they may become capable of speeding up time-intensive processes such as document and report reviews; however, there's still some way to go in achieving proficiency in natural language – an area where a large part of AI research is focused. There is also domain-specific legal language which is difficult to understand, making it harder for AI to achieve natural language proficiency in the legal context. Lawyers will still be required to engage in reliability checks for some time to come.

Significant risks with AI remain, not least data protection and confidentiality and there was caution against using consumer-facing AI tools for business purposes on data privacy grounds.

#### Building out the SWF Legal and Compliance Function

A panel comprising a General Counsel, Senior Tax Counsel and Head of Compliance from three leading SWFs debated the role of the legal and compliance function, how to build it and how to engage with government/state stakeholders. The interaction between SWFs and government often requires legal and compliance teams to balance demands from government to support and develop local talent whilst ensuring sufficient experience and bench strength in the team. Augmenting 'home grown' talent with private sector hires is often the solution.

To deliver real value the legal function needs a solutions-oriented approach rather than simply seeking to identify problems – a critical ingredient for building and maintaining credibility within the organisation. Centralised and decentralised models were debated and the panel agreed that the choice will often be determined by the size of the SWF and the breadth of its investment mandate across markets and geographies.

### ► Role of the SWF in the Macroeconomic and Geopolitical Landscape

The Summit kicked off with a discussion on the role of the SWF on the global stage. It was recognised that exceptional uncertainty prevails, with slow GDP growth, high debt levels, sticky inflation and the increasing economic impact of climate change.

The role of central banks in keeping monetary controls tight and retaining liquidity levels was recognised, together with the importance of pursuing structural economic reforms and prioritising, amongst other things, the role of women within the national economies.

SWFs can have an important influence in this regard through promoting adherence to the Santiago Principles, reinforcing sound legal and governance structures and ensuring clear and transparent mandates, accountability, and separation of ownership from management. The stabilising effect of SWFs' 'patient capital' model can reinforce this influence.

Sovereign debt levels remain a key issue for some countries, particularly as the world enters an era of high interest rates and slow/stagnant growth. On top of this, rapid and far-reaching technological advances (particularly in AI) could herald a substantial rise in unemployment in certain sectors.

A question from the floor prompted an interesting discussion on the future of the US Dollar as the primary reserve currency and the emergence of other national currencies as competitors for this title.

### ► Maintaining Market Integrity and Restoring it when the Crisis Hits

The Summit concluded with a panel discussion on the increasingly important topic of crisis management, market integrity and reputational risk for SWFs.

As SWFs become ever-more active in the global investment environment, they face increased public scrutiny. It is especially important that SWFs maintain integrity since, unlike other investment institutions and financial market participants, they tend not to be subject to external regulatory oversight. For this reason, internal governance and codes of conduct are vital to a SWFs brand protection.

Integrity matters for SWFs from three principal perspectives: government/other stakeholders, market counterparties, and employees. And considering that SWFs now represent around 10% of the global investment market, the stakes are high.

The panel discussed the so-called 'PESTLE' strategy for crisis preparedness which seeks to identify reputational and other risks through a vulnerability analysis considering Political, Economic, Sociological, Technological, Legal, and Environmental factors, and stress-tests the SWF by creating a bespoke scenario to assess how a crisis is handled. This requires identifying key leaders and function heads within the organisation and being able to contact all of them immediately when a crisis hits. Maintaining an ongoing dialogue with this group in 'business as usual' periods is also vital to achieving the right state of preparedness.

It was agreed that a pragmatic approach to crises is necessary whilst recognising that a SWF's reputation is paramount. There is also often more than one stakeholder to worry about - when there is an investigation, it is often revealed that multiple things have gone wrong rather than just one at the hands of one person.

### ► Regulatory Headwinds in Deployment of Capital by SWFs

A panel explored the increasing influence of foreign investment restrictions (FIR) across major economies on SWFs' ability to deploy capital. The UK government's strategy in this regard was spotlighted in the wake of the National Security and Investment Act, 2021 – this can be summed up as encouraging foreign investment and an open-door approach to dialogue with SWFs focusing on the UK as an investment destination. The sensitivity of the target, the rationale for the investment and the overall investment strategy are factors which affect the decision in individual cases but with intervention in only 14 of circa 800 transactions notified last year it appears the UK government's strategy is borne out in practice.

FIR has a huge focus in the US and developed economies across Europe, however whilst the US is focusing on decoupling whilst the EU is centred around de-risking.

New EU rules on foreign subsidies, whilst well-intended have caused some issues, in particular identifying which financial contributions from non-EU countries fall within the scope of the regime. There was a consensus that the new rules are adding to the disclosure requirement for SWFs.

The panel also discussed how SWFs are managing the FIR review and compliance process for their transactions and integrating this into their overall investment process – consistency of approach to interactions with different regulatory authorities, leveraging internal teams and outsourcing to law firms were all discussed. Caution was also expressed against automatically filing in cases where the facts don't require this, so as to avoid setting a precedent with the regulators.

### ► SWFs in Disputes – Immunity from Suit and Enforcement

SWFs are increasingly visible actors in global investment flows and high-profile transactions. Their growing appetite for influence, and even control positions, in deals has tended to create more situations where they are also leading on resolution of disputes in such deals. This brings sovereign immunity into focus.

Although sovereign states usually enjoy immunity, there are key exceptions, such as where the state is carrying out foreign business or where it is entering into a commercial transaction. Consequently, most (if not all) investment activity by SWFs will not benefit from immunity from suit or enforcement.

In spite of this general rule, contract counterparties to SWFs will often seek written waivers of immunity from SWFs and these should be carefully considered in the context of the type of SWF, its legal form and relationship with the home state (including whether there is affective separation between the two). To examine this issue, the courts consider whether the SWF board makes decisions regarding the day-to-day running of the entity, or whether the decisions effectively come from the head of state or government. Any express waiver of immunity may result in increased risk in relation to future proceedings so should not be done lightly.

Increased levels of investment activity by SWFs, some of which has attracted significant publicity as well as threatened litigation or regulatory enforcement action, means that SWFs are paying much more attention to issues of sovereign immunity and litigation risk than was previously the case.

## ► Private Markets

A series of panels focused on important aspects of private markets where SWFs are active:

### Infrastructure investment

SWFs' appetite for longer-term investments, aligned with their permanent capital model has long made infrastructure an attractive asset class. A panel made up of SWF general counsel, an infrastructure fund manager and Baker McKenzie experts discussed this. The traditional 5-7 year investment horizon for infrastructure deals is now stretching to 15-20 year life cycles and, in some cases, an open-ended approach is favoured. The panel debated the sponsor-led investment model of 10 year closed-ended funds which has engendered certain expectations in management teams for financial rewards predicated on a capital event (usually an exit of the investments) within the life of the fund. This can be at odds with the 'patient capital' investment model of SWFs where assets can be held for much longer time periods, added to which, once the asset is stabilised, some SWFs consider traditional management incentivisation through carried interest to be over-generous.

The panel debated the role of ESG in infrastructure investing and agreed that level of sophistication and governance in the ESG has increased across all asset owners. The "E" in ESG is becoming more important for investors considering longer term impacts, such as climate change and government responses. Assisting companies to reach Net Zero and eventually generate better returns is key for investors looking to do the right thing and avoid reputational damage.

Foreign investment regimes are also perceived as a major hurdle to infrastructure investment. With a few notable exceptions, the actual risk of an SWF being blocked from a proposed investment is usually low – however, the SWF GCs on the panel agreed that the administrative burden stemming from the proliferation of national and supra-national FIR regimes has meant they've needed to build capacity in this area if they want to secure a place at the table on infrastructure deals, in particular where they are joining a consortium of investors. Deal timetables have also lengthened to accommodate filing and clearance processes. It was agreed that the public affairs departments of SWFs have an important role to play in engagement with regulators and governments in this area.

### Co-Investments in Private Market Assets - Securing Greater Exposure to Top Sponsors and Investment Opportunities

The discussion then segued to the broader theme of the SWF relationship with sponsors across alternative assets generally. A panel comprising a former investment director for a middle eastern SWF and a real estate investment banker debated the topic with two Baker McKenzie partners. The panel agreed that the tried and tested route to good quality co-investment opportunities is through fund investment with top-quartile managers, but with contractual guarantees of a co-investment allocation being rare, the SWF's relationship with the GP is critical.

Alignment of interests is important and, given that co-investment capital generally does not generate management fee or carried interest for the sponsor, they will continue to favour their larger fund LPs for the trophy co-investment opportunities.

From the sponsor-side, the 'ideal' LP is one which: is relatively passive and not seeing control, has a track-record of successful partnerships with the GP, has a similar risk appetite and is aligned on objectives, culture and philosophy.

For the LP, the key things to look for are: cost-effective and tax-efficient structuring, no management fees or carried interest to the sponsor, good governance, access to and reliance on due diligence, enhanced reporting and alignment on exit.

### Active Portfolio Management in Private Funds

The GL/PL relationship was further explored by a panel comprising two secondary fund managers, a secondaries financial adviser and a Baker McKenzie tax partner. With the secondaries market now worth around \$120 billion annually and SWF exposure on both the LP and GP side, this is an area where SWFs are increasingly active. There are several drivers: the so-called denominator effect, where, in a down-cycle, the carrying value of non-public alternative assets becomes relatively greater than public market assets which are marked to market – consequently, SWFs are finding themselves in breach of their own asset allocation rules and needing to off-load private market assets; the desire to re-balance fund investment portfolios to secure greater exposure to top vintages; and the difficulty encountered by sponsors in identifying exit opportunities for portfolio investments towards the end of a fund's life.

The rise of the continuation fund as a solution to fewer traditional exit opportunities was discussed. SWFs need to be alive to the potential for conflicts of interest and seek comfort that assets transferred from the main fund to a continuation fund are valued independently and the continuation fund is separately advised. SWFs need to decide whether to roll their investment into the continuation fund or cash-out at the valuation offered – it was agreed this is not always an easy decision where the GP is not in a position to give independent advice.

### Fund Investing: Deep Dive on Side Letter Terms for SWFs

A further panel dug into the side letter in SWF fund investments – a critical tool for SWFs to secure essential rights and concessions for their fund investments. Often SWFs begin with key terms they are unwilling to depart from, or non-negotiable positions which are dependent on factors such as local legislation, or proscribed categories of investments. Heavily negotiated areas include tax terms (sovereign immunity from tax being key), information rights, transfer provisions, alternative investment vehicles, use of name and most favoured nations processes.

## ► Public Markets and Digital Assets

### Navigating key themes for SWFs in public markets and digital assets

Public markets are now more open to SWFs; however, they face challenges in needing to make decisions without access to the extensive due diligence normally available in private market deals.

SWFs tend also to be heavily involved in IPOs of state-owned companies and the last year has seen a number of high-profile examples. This inevitably results in greater scrutiny and governance burdens for SWFs which often retain controlling stakes in such companies. Listing venue is a key decision in this context, and we have seen significant competition between London and New York in particular in this regard.

The discussion moved to the increasing prevalence of digital assets in the investment landscape. Despite market volatility, regulatory uncertainty and general enforcement, there is growing adoption of sophisticated blockchain infrastructure in traditional finance.

The ecosystem has expanded to include parties from a variety of backgrounds, and it is anticipated that blockchain will eventually become an ancillary feature of finance rather than a disruptor.

Maintaining open and regular dialogue with regulators is imperative to understand the concerns associated with blockchain. SEC action against Coinbase and Binance are two recent examples of regulators taking decisive action against cryptocurrency companies which failed adequately to protect investors. It seems that different jurisdictions are taking divergent approaches, such as the targeted approach (Singapore), vs the holistic approach (EU).

Institutions are increasingly replacing direct investment in digital assets/financial products/derivatives/exchanges with investments in digital asset funds, or companies with a broader digital asset exposure. This balances de-risking direct liability exposure with the inevitable evolution of regulation.

## ► Guest Speakers

We thank our guest speakers for their invaluable contributions to the Summit:

**Rhoda Weeks-Brown** (General Counsel, IMF), **Karen Ward** (Chief Market Strategist, EMEA, JP Morgan Asset Management), **Richard Collins** (Strategic Governance & Compliance Consultant), **Dirk Hartung** (Executive Director, Bucerius Law School), **Susanna Berger** (General Counsel, EMEA, KKR); **Mei Mavin** (Head of Corporate Communications, CPPIB), **Charles O'Brien** (Partner, FGS Global), **Rajesh Pillai KC** (3 Verulam Buildings), **Jacqui Ward** (UK Cabinet Office Investment Security Unit), **Andrei Brougham** (MD, GP Solutions, Rothschild & Co.), **Vjerana Burleigh** (MD, Secondary and Portfolio Finance, AlInvest Partners), **David Jeffrey** (Head of Europe, StepStone Global), **Ka-Mun Tao** (European Counsel, Infrastructure, KKR), **Sami Al-Bashir** (Managing Partner, Atlas Partners), **Sue-Lin Heng** (MD, Eastdil Secured), **Michael Lampshire** (Head of Funds Legal, Apax Partners), **Claire Suddens-Spears** (Head of Equity Advisory, Rothschild & Co.), **Tom Attenborough** (International Business Development, London Stock Exchange), **Olivia Broderick** (General Counsel, Bitpanda), **Marc Niederkorn** (MD, SNCI), and **Nelli Zaltsman** (Lead Product Designer, Onyx at JP Morgan).

## ► Baker McKenzie Contacts

If you would like to discuss any of the topics covered at the Summit or require further information on our Sovereigns offering, please contact your usual relationship partner or one of the following:



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