

A changing world creates challenges and opportunities for sovereign wealth funds

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A partner at Hogan Lovells since joining the firm in June 2016, Babak Nikravesch works out of our Silicon Valley and San Francisco offices. He represents government-linked investors on cross-border investments and regulatory, tax, and operational issues.

Can you describe your practice?

Nikravesch: I devote a significant portion of my practice to working with sovereign wealth funds, public sector pension funds, social security funds, and other government investors, helping them with their investments as well as many other issues. I've been doing that for the better part of 15-20 years. It's a very specialized field that probably wasn't as well known until about 2008 or so.

What has brought sovereign wealth funds increasingly into the public eye in the last decade?

Nikravesch: In the later stages of the financial crisis in the United States there were a number of investments by foreign governmental investors in high-profile assets, including some that were considered national strategic assets. Suddenly these investors were thrust into the public consciousness. Maybe partly for the sake of publicity and newspaper sales, a lot of sensationalist ink was spilled writing about them, and not all of the coverage was accurate.

How can Hogan Lovells help clients navigate the challenges sovereign wealth funds face?

Nikravesch: These organizations are increasingly subject to government regulation and are finding themselves captured by the scope of legislative regimes that were not designed with them in mind. That creates new challenges for these organizations to navigate.

When I was considering a platform for this practice, I was looking for a place that would allow me to best serve my clients. I was aware of Hogan Lovells' reputation in private equity, real estate, and government regulation, having done deals opposite them for a number of years. These are global organizations, so it's important to be able to offer them resources that are truly global. We have a presence in every populated continent, so we are able to offer what they need.

Are there particular trends and challenges that you are seeing in the current market?

Nikraves: These institutions invest globally and often face complex tax issues depending on where they want to invest. They may enjoy tax exemptions at home, but they may not have a blanket exemption abroad. There are lots of traps for the way and the unwary with regards to managing those exemptions.

I advise these organizations on specific tax implications of their investments, an ever-changing issue because the asset classes that they target have changed as these funds have evolved. Traditionally it was just treasuries and bonds, very low-risk (and low-lawyered) investments, but they have expanded to alternative assets like real estate, private equity, infrastructure, and debt. As their investment focus expands, the tax and associated issues become more complex.

In terms of trends, I would point to the increased desire by these investors to pursue direct investment opportunities. Here in Silicon Valley we see that manifested by a number of significant late-stage VC deals, but it happens across multiple assets classes as these funds seek to take greater control of their deals and reduce their fee burden when doing deals with sponsors.

Are you seeing more ethical investing by sovereign wealth funds? Several national pension funds apply ethical criteria to their investments. Do you help on that side too?

Nikraves: I do not advise on that aspect of their transactions. But I will tell you that a fairly large number of these funds do take those issues into account — what are referred to as “ESG”, or environmental, social, and governance considerations. Even for those sovereigns that don’t have that specific policy in mind, many have other concerns, like investing in tobacco or armaments. Unlike your typical private investor, sovereign wealth funds are particularly subject to public scrutiny. They are creatures of government and as such are subject to internal domestic politics, and have to be very mindful of their domestic and international profile.

That leads on to something else — the world is going through a period of geopolitical fluctuation. Are your clients reassessing their investment outlook based on the changing political climate?

Nikraves: Absolutely, and I would say that many of them began considering changes even before the Brexit vote took place. This notion that the established way of governance is changing is giving people pause. A lot of investors were waiting to see how it shakes out, particularly before the U.S. elections, and were keeping their powder dry. Importantly we have elections in the Netherlands, Germany, and France this year. So globally there is potential for yet more change to come.

Part of that geopolitical change is a rise in nationalism. Are your clients concerned about that and its possible impact on their ability to invest?

Nikraves: I have not heard it phrased that way, but these are global investors, organizations that invest in multiple asset classes, predominately in developed economies but increasingly in developing economies. To the extent that the investment climate is less hospitable to foreign investors — that would be a concern.

Remember, back in 2007 and 2008 these funds were often cast as potential villains, their moves viewed with suspicion. However, during the financial crisis, several stepped in and invested much-needed capital in a number of capital-starved corporations at a time of incredibly tight liquidity, and were suddenly viewed in a different light, white knights if you will. Capital that was scarce was suddenly available. They provided liquidity when there was none, and it was long-term capital. That helped establish that these are overwhelmingly financial, not strategic, investors. Sovereigns provide much needed capital that is not readily available. Consider this: according to McKinsey, approximately US\$57 trillion is needed by 2030 to finance much-needed infrastructure projects in energy, transportation, and water. Where is that going to come from? Most countries don't have the tax base to support that need.

So, yes I think they are concerned about anything that might impact their potential to invest abroad without adding to issues that already exist. But any country that needs foreign investment needs to temper any nationalistic instincts there may be in order to remain attractive to capital.

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