Investing in Transition: Annual Meeting 2023

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Introduction

The 2023 Annual Meeting of the International Forum of Sovereign Wealth Funds (IFSWF) met in late September under the broad theme of Investing in Transition. The three days of meetings offered an opportunity to recall the first formal convenings of SWFs in 2008, when the community consisted of 26 members of the International Working Group (IWG), primarily stabilisation and savings funds. Those earliest meetings of the IWG were conducted during the global financial crisis, with delegates under immense pressure, charged with the immediate task of negotiating principles for SWG governance. Many delegates at the time had not previously met nor knew even each other.

The intervening years brought forward the IFSWF and a dramatic expansion in membership to 48 full and associate members, including a large contingent of development and strategic funds. IFSWF annual meetings also have evolved to now resemble symposia – collegial forums for open exchange and discussion, information sharing, collaborative learning, and certainly networking. The 2023 Madrid was precisely that. The city made for a welcoming venue, and COFIDES, the host member, working with the IFSWF Secretariat, designed an engaging agenda focused on transitions in the areas of global security, economy, and technological transformation. However, in both formal sessions and informal meetings, discussions extended well beyond the boundaries of these transitional – and, in fact, intersecting – themes.

Global Security

Certainly, growing concerns over geopolitical risk were interwoven into many conversations as the global political landscape becomes more fragmented, and characterised by increased competition, deglobalisation as a competitive strategy, and disputes and tensions that erupt into open conflict. As state-owned institutions, members necessarily face indirect impacts from national security challenges faced by national governments. These include, for example, market access and potential supply chain disruptions and extend to energy security and economic security, more broadly. However, as institutional investors – many universal investors – members must also manage the risks to their portfolios posed by geopolitics and its economic consequences, even as many of these risks are becoming increasingly more difficult to diversify.

International Economy and Capital Flows

Global, regional, and national economic challenges are not decoupled from, but rather linked directly to, heightened global security risks. Whereas some eight years ago SWFs were contemplating a world of “lower for longer” inflation and interest rates, today, weak regional growth and inflationary pressures stemming directly from higher energy and food costs have led to elevated interest rates and tighter financial conditions across markets. Questions related to a structural transition in the direction and pace of change of both inflation and rates were debated but without a clear resolution. There was, however, consensus that volatility in inflation, and so rates, would remain high due to greater geopolitical uncertainty, with resulting impacts on energy and food security, thus requiring a more strategic approach to portfolio risk management.

Notwithstanding this cautionary outlook, discussions focused on the role of SWFs in maintaining and advancing global investment, particularly in new technologies (e.g. green tech and AI) and in emerging economies. As long-term sources of patient capital with a diversity of mandates, SWFs viewed themselves as contributing to global investment through their capacity to de-risk and catalyse international capital flows. This thread of discussion focused particularly on savings and strategic investment funds, which are tasked to achieve financial and development policy objectives through partnerships that mobilise global institutional capital for domestic investment. In no sector were de-risking and catalytic investment as central to the debate as in discussions over the pace and scale of the energy transition.

Energy

Whether in plenary meetings or sidebar conversations, members' attention continually refocused on the core paradox of the energy transition: Despite heightened scrutiny and increasingly amplified calls for action, progress toward global emissions reduction goals has been slow, plagued by under-investment, disparate regulation, weak systems-level interoperability, still unproven technologies, and underdeveloped human capital. Discussions concerning a pathway to accelerating progress pointed toward greater global coordination and collaboration between multilateral development institutions, national policy makers, and both public and private investors. Conversations were detailed and solution-oriented, beginning with calls for enabling tools, such as stable and predictable regulatory frameworks and deeper and better integrated global carbon markets, yet also included expectations for progressively more investible projects and technologies.

Mindful of the risks, SWFs also acknowledged the opportunities the transition presented to long-term investors, whether through investments in early-stage companies innovating across the climate technology spectrum or in renewable energy solutions targeting decarbonisation. They were also fully aware of the competitive advantages they shared as large financial institutions, not least their extensive global networks, capacity to build and nurture long-standing partnerships, and their ability to bear liquidity risk. Each of these pointed back to – and substantiated – the role of SWFs in blended approaches to financing the energy transition that aligned risk and return among investors while catalysing investment in scale across the multilateral, public, and private sectors.

Technology

Technology was an intersecting theme across many sessions, including climate, security, and broad applications of artificial intelligence (AI). Cybersecurity, for example, was featured in two sessions with members attending each well-cognisant that operationally cybersecurity risks are pervasive among both governments and global financial institutions and so of particular importance to SWFs as requiring constant vigilance to defend. Especially interesting is the technology leadership role that some members, due to their scale and degree of global connectivity, play domestically, collaborating with government cybersecurity teams on new technologies and best practice implementation and technology management strategies.

Applications of AI were generally discussed in the context of investment and risk analysis, including tools to evaluate geopolitical risk – and, by extension, cyber risk – threats. With respect to investment analysis, members discussed their experiences, including testing parallel pilot applications to examine the effectiveness, but also the limitations, of AI models. An important dimension of these discussions involved possible changes in the role of human factors in investment decision-making, including the actionability of results of AI processes and the need for modifications to investment governance protocols.

Governance

The transition theme – perhaps circuitously – also found its way into a very informative session on SWF governance that featured the founding CEOs of strategic investment funds, who have both recently transitioned to the private sector. The conversation was directed to a plenary session; it was open, experiential, and prescriptive. Its takeaways were less focused on the Santiago Principles per se, than on successful approaches of their implementation for sovereign investors regardless of mandate.

For both speakers, primary emphasis was placed on the critical need for effective communication with stakeholders. This includes being transparent in reporting to government shareholders, while being publicly accessible to other government and public stakeholders, mindful that the degree of a fund's transparency (versus disclosure) is the prerogative of its owner.

Both speakers also stressed the importance of operating under a defined investment strategy and clear investment objectives built on consensus, publicly articulated, aligned with investment policy, and executed without external intervention. Equally as important was operational resilience driven by strong processes, robust documentation, and a commitment to developing human capital. In this regard, emphasis was placed on the role of the fund as a partner to the government with expertise in the functioning of global financial and product markets, and thus capable of closing institutional gaps and bringing market-based solutions to their shareholder-owners.

Climate Change

Based on the foregoing, the discrete question of climate change, the most obvious transition risk to long-term investors, may seem conspicuously under-represented in discussions at IFSWF 2023. In fact, attention to climate risk and the need for climate action was a pervasive undercurrent across sessions, as members contemplated the interconnectivity between climate change and megatrends that directly and indirectly linked to climate impacts. Not least among these trends are urbanisation, shifts in global migration patterns, and expected economic disruptions that will require unprecedented pre-emptive investment in mitigation and adaptation solutions. In this context, deciphering risk from opportunity will be challenging and require massive scaling, prompting one SWF CEO to reinforce the need for collaborative partnerships to which SWFs – across all mandates – are well-positioned to contribute. "**We cannot afford <u>not</u> to be catalytic**", he stated definitively.

As the meetings wound down, preparations were already kicking-off for the IFSWF 2024 annual meeting to be held in Muscat, Oman. The transitional challenges and risks discussed in Madrid will inevitably follow there. Advancing to collective solutions will require building on the collaboration and partnerships, which convenings such IFSWF annual meetings engender.

IFSWF would like to thank COFIDES for hosting our 2023 annual meeting.

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