

HOW GLOBAL SWFs ESCAPED A “TRIPLE DRAIN” ON THEIR ASSETS: LESSONS & INSIGHTS FOR THE NEXT GLOBAL CRISIS

1. Introduction

At the onset of the global pandemic in April 2020, analysts at Konfidants spotted a troubling phenomenon they dubbed “the triple drain” on assets of SWFs and predicted that it could wreak a \$2 trillion havoc on the \$8 trillion fortunes of SWFs globally -- if the pandemic prolonged beyond 4 years. The Triple Drain was essentially a Konfidants hypothesis that the pandemic would force SWFs to lose money and assets via three major mechanisms that would play out simultaneously, namely:

- *liquidating assets to shore up government budgets to fight COVID-19,*
- *losing money on investments (as corporate profits and stock markets tank) and*
- *losing much of the annual funding allocations they receive in normal times (as a result of collapse in prices of the commodities that feed many SWFs, and the fiscal crunch starving non-commodity SWFs)*

The assessment was predicated on several indicators including historical analyses of global stock market recovery cycles, recovery outlook for

commodity prices, the magnitude and speed of Covid-19 spread across the globe, the novel nature of the pandemic, and the rate of global economic meltdown, among others. In fact, at the time of issuing the report in April 2020, global SWFs had already lost at least \$1trillion in global markets .

Undeniably, the “triple drain” materialized as SWFs:

a) Liquidated assets to support government budgets: In the heat of the pandemic, some SWFs liquidated their assets to smoothen government expenditure. This was common primarily among stabilization Funds, although some Savings Funds were also tapped to support government spending. Some examples include:

- Nigeria’s NSIA approved a withdrawal of \$150 million from its Stabilization Fund
- \$219 million was withdrawn from the Ghana Stabilization Fund to help fight Covid-19
- The Iranian government approved a withdrawal of 1 billion euros from the country’s SWF
- Azerbaijan’s SOFAZ supported government’s budget with \$2.7 billion
- The Norwegian government withdrew \$37 billion from its sovereign wealth Fund to support government budget

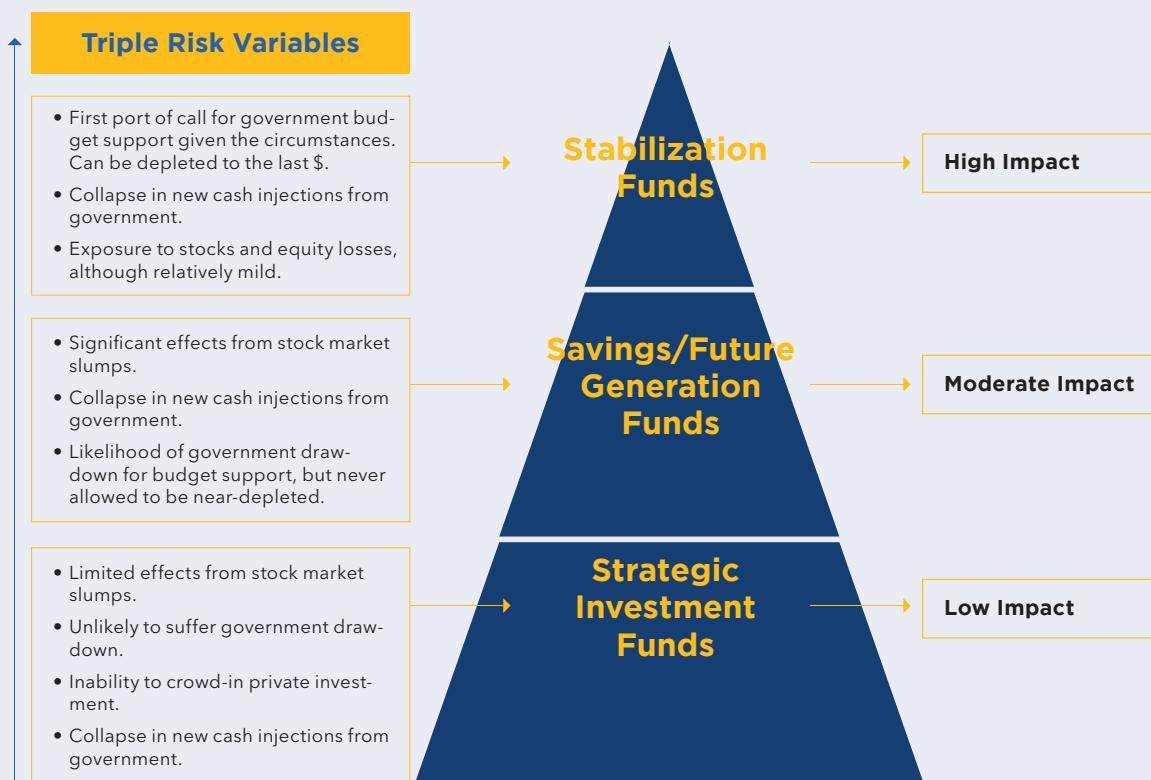
b) Lost money on their stocks and equity investments due to stock markets decline: In the early days, the high degree of uncertainty surrounding the Covid-19 pandemic caused panic selling among investors in stock markets across the world, causing markets to plummet to a historic low (for instance S&P dipped 34% by March 23, 2020.) Below are some examples in this regard:

- Both oil-based and non-oil-based SWFs recorded about \$1 trillion dollars in equity losses towards the end of March 2020
- The Norwegian SWF recorded a \$113 billion in stock market losses by Q1 2020
- The total AUM of Alaska’s SWF declined from \$64.9 billion by February 29 to \$58.7 billion by March 16, 2020

c) Suffered from non-injection of regular funding: Both commodity and non-commodity SWFs suffered from non-injection of regular funding allocation by governments. The closure of global supply

chains, and widespread lockdowns halted gains from both commodity (such as oil and gas, gold, etc.) and non-commodity exports, thereby starving governments of regular revenues, of which some proportion is allocated to Sovereign Wealth Funds.

The Triple Drain Hypothesis in one Chart



Source: Konfidants 2020

2. A Lucky Escape

Sooner than projected, the harsh effects of the pandemic started to wither, and SWFs and their governments managed to stave off/avoid the worst of the “triple drain.” Contrary to expert analysis and projections, the stock markets rallied to pre-crisis level in record time (in about 1 year), commodity prices recovered faster than expected and have since skyrocketed. The spread of the virus slowed due to an unprecedented early vaccine discovery - less than the 2 - 5 years vaccine feasibility timeline estimated.

The swift improvement was fueled by a host of reasons and some luck. Some key measures that contributed to the recovery process include unprecedented gigantic stimulus measures initiated by governments to support businesses and households, and heightened investments into scientific research and experiments for a vaccine. Consequently, the pharmaceutical and biotechnology industries, recuperated market losses by early June 2020; and about half of the sectors fully bounced back within 7 months after the stock market had tumbled to its lowest point.

3. Avoiding Future Triple Drains: Lessons & Insights for how SWFs could respond to the Next Big Crisis

Having observed the complementary multistakeholder approaches adopted by Sovereign Wealth Funds, governments, global and regional multilateral institutions, and bilateral development agencies, among other stakeholders to lessen the magnitude and effects of the “triple drain” on SWFs, we believe that there are important lessons here to document for how to avoid future “triple drains.” These lessons are crucial because “the triple drain” risk is one that SWFs must constantly prepare for when the next big crisis strikes.

- a) Blend both “defensive and offensive” strategies to weather the storm:** At the height of the pandemic, when most experts only thought of activating the ‘rainy day’ functions of SWFs to support governments’ reconstruction and recovery efforts, some SWFs, especially the GCC Funds engaged a portfolio rebalancing and asset re-allocation approach. This proved successful in building Fund resilience. Today, Asset under Management of most GCC Funds is higher than the pre-crisis level as a result of commodity price recoveries that reinforced smart offensive investment strategies. Therefore, during crisis periods, Funds should engage the double-edged strategy of supporting their government budgets, while also seeking investment opportunities amid the chaos. In short, “never waste a crisis.”
- b) Provide for Flexibility in Fund Mandates:** The Mandate of Funds, with respect to stabilization, savings, or development; as well as the diversity and composition of investment portfolio should be flexible enough to accommodate adjustments to government needs or prevailing circumstances. For example, Angola’s FSDEA which is created primarily as a development and savings Fund was technically

'reconfigured' with a stabilization mandate when the government withdrew \$1.5 billion for budget support during Covid-19. Also, technology, healthcare, warehousing, and logistics (sectors that thrived during the pandemic) saw an increase in SWFs investment portfolio, whereas real estate investments declined during the pandemic.

- c) Diversify Funding Source:** The decline in commodity prices during the Covid-19 pandemic resulted in capital starvation for commodity-based Funds as their governments suffered a shrinking fiscal space and heightened budget deficit. This highlights the need for multiple sources of Funding for single-sourced SWFs as a measure to hedge against the risk of Fund depletion, thereby improving resilience and Fund sustainability.
- d) Pursue Partnerships and Collaboration:** Collaboration among Funds, asset managers, and other key strategic partners is necessary to augment the financial and technical strengths of partners to effectively combat crises. Some of the notable partnerships identified since Covid-19 struck include: Mubadala's partnership with Blackrock for secondaries; with Silver Lake for technologies, and with Apollo for private credit.
- e) A Coordinated Global Response is crucial:** The need for a coordinated global response to overcome crises of this nature cannot be overemphasized. Governments should support one another, as seen in the support of developing countries by developed countries in various ways like vaccine development, production of test kits, etc., For instance, vaccines were developed by countries and institutions with knowhow and capacity; and distributed to developing countries where they lacked the required capacity.
- f) Intervention of Multilateral & Bilateral Institutions:** In periods of crisis, the assistance of multilateral and bilateral agencies to support governments, sometimes with unconventional mechanisms is important. Many institutions like IMF, World Bank, OECD-DAC, AFD, DFID, JICA, USAID, etc., were instrumental in this regard.

Interventions like the World Bank's Fast track facility, grants and concessional loans, as well as IMF's Rapid Credit Facility, Extended Credit Facility (ECF), Rapid Financing Instrument, Special Drawing Rights (SDRs), and debt service relief among others played a critical role in reducing the financial resource that SWFs, especially in developing countries would have withdrawn for government budget support. While the IMF approved about US\$ 650 billion in SDRs to

its members, the World Bank provided US\$ 204 billion of financial assistance to both public and private clients between 2020 - 2021.

g) Government Borrowing: Covid-19-induced government revenue shortfalls and increased expenditure forced several governments to undertake unprecedented levels of borrowing from several sources including domestic and external financial markets, to shore up governments' crisis-time expenditure.

The above lessons and insights are critical factors for Sovereign Wealth Funds to navigate the next big crisis. These factors contribute to resilience building, Fund sustainability, and reduce the degree of financial obligations that SWFs would typically face in periods of crises. While we consider these points crucial to tackling the next crisis, we also advise that they are adopted based on an analysis of the various country contexts, the nature of crisis, heterogeneity of industries, and the ever-changing financial market and SWFs investment landscape.

Authors

Godwin Owusu, Michael Kottoh, Bismark Addo, Joshua Ansah contributed to this article

About Konfidants

Konfidants is an international advisory firm of consultants, scholars, and advisors that specializes in supporting companies, governments, and international organisations to achieve impact. Konfidants publishes the African Sovereign Wealth Funds Index.

Contact: advisory@konfidants.com

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