OECD/Euromoney Conference on Long-term Investment Financing

Remarks by Stefan Kapferer,
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(As prepared for delivery)
Ladies and Gentlemen,

It is my great pleasure to welcome you to this Conference on Long-term Investment Financing, part of the OECD Institutional Investors and Long Term Investment project [OECD Long Term Investment project] and co-organised with Euromoney whom I wish to thank for its excellent work despite the challenging circumstances. I would also like to thank the sponsors for helping to make this event possible.

An uncertain economic outlook

Seven years after the crisis and a robust recovery remains distant. In spite of recent improvements, most of the OECD countries are still experiencing low economic growth, high unemployment, growing economic inequality, and eroding trust in institutions. The engines of growth are only slowly recovering, while those in emerging economies are decelerating.

If we look ahead, the short- and long-term perspectives are sobering. In 2015 and 2016, growth in OECD countries is expected to average 2.0 percent and 2.2 percent, respectively\(^1\). Even in the long term, we foresee a coming era of slower growth due to a combination of lower investment, unfavourable demographics and weak productivity growth. According to an OECD study, aging populations in many OECD countries and a gradual slowing of high growth rates in the large emerging economies will trim increases in global GDP from an annual average of 3.6 percent in the 2010–20 period to an estimated 2.4 percent in 2050–60\(^2\).

The threat of so-called ‘secular stagnation’ remains high, especially in Europe. Meanwhile, new global risks gather on the horizon: the build-up of debt in emerging economies, the return to bullish risk-taking in global financial markets, and rising geopolitical tensions in Eastern Europe and the Middle East.

Let me briefly share some views on the evolving role of the financial sector in providing an engine for growth and employment, and the role of institutional investors in the new financial landscape.

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\(^1\) OECD Economic Outlook November 2015

A financial sector that works for people: Reforming finance and supporting Long term investment

At the OECD we are working intensely with Member and Partner countries to ensure that the financial system can perform its vital role as an efficient intermediary between savers and borrowers.

We need sound and efficient financial markets and institutions, operating according to rules and procedures that are fair, transparent, and free from conflicts of interest, instilling consumer and investor confidence. At the same time we must also ensure the contribution of finance to growth, focusing on financing the real economy and the role of institutional investors in long-term investment financing.

Such considerations are at the heart of the OECD Long Term Investment Project, which acting as a bridge between investors and governments, aims to facilitate long-term investment by institutions.

The importance of long-term finance lies in its pivotal role in satisfying long-term physical investment needs across all sectors in the economy and specifically in key drivers of growth, competitiveness and employment such as infrastructure, real estate, R&D and new ventures.

With over USD 50 trillion in assets in OECD countries alone, institutional investors such as pension funds and insurers are frequently cited as alternative sources of financing. However these investors are facing challenges of their own which may lead to hesitation on their part to commit to long-term investment opportunities.

Long-term promises and the funding gap: the challenges facing pension funds and life insurers

The current low-growth, low-interest rate environment poses particular problems for pension funds and life insurers. These financial intermediaries, which offer long-term financial promises, rely on investment returns to honour their obligations. Our recent publication Business and Finance Outlook- to be further discussed in a special session this afternoon [by Adrian] identifies significant funding gaps as annuity promises based on existing mortality tables show shortfalls in many countries, both from rising longevity risk and from lower interest rates.

Increasingly, therefore, pension funds and life insurers are feeling the pressure to chase yield, and to pursue higher-risk investment strategies that could ultimately undermine their solvency. This not only poses financial sector risks, but potentially jeopardises the secure retirement of our citizens.

As pension funds and insurers allocate more capital to alternative assets, and increasingly interact with the shadow banking system, regulators and policy makers will need to remain vigilant. At the same time, promoting infrastructure and other long-term, productive investments by these institutions can help raise real returns on capital in advanced economies more generally, thereby improving structural conditions for business and the financial sector.

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3 OECD Annual Survey of Large Pension Funds and Public Pension Reserve Funds, OECD 2014.
Facilitating the participation of Institutional Investors

The role of institutional investors in long-term financing is constrained by the short termism increasingly pervasive in capital markets, as well as structural and policy barriers such as regulatory disincentives, lack of appropriate financing vehicles, limited investment and risk-management expertise, lack of transparency, and a dearth of appropriate data and investment benchmarks for illiquid assets.

Given the constraints on government budgets and the considerable need for long-term investment now and in the future, particularly for green infrastructure, it is essential that countries improve the efficiency of the use of resources and partner with the private sector to meet some of these investment needs. Here, a recent OECD Taxonomy of Financial Instruments presented to the G20 describes the available investment channels and investment instruments (such as project bonds or equity funds) that the private sector is using to deploy capital in infrastructure assets.

Tools for governments to leverage institutional investment include public–private partnerships to develop clear and transparent project pipelines for major green infrastructure projects, green banks, which provide low-cost financing for clean-energy projects, and various risk mitigants such as guarantees and stronger contract design that build confidence in long-term infrastructure investment. These risk-mitigation and credit-enhancements tools (the Juncker Plan is one example) can help to ensure that institutional investors gain access to financial vehicles with the appropriate risk-return profile.

It is therefore conclusive that G20 governments currently play an important catalytic role with respect to the mobilization of private financing, in addition to any direct funding provided for projects.

Ladies and Gentlemen:

We still have a long way to travel to make financial markets work for people. We can certainly escape the ghost of secular stagnation and we can achieve more resilient, more inclusive and more sustainable growth. But we will only succeed by using new economic thinking, focusing on the quality of growth. This is what we are doing at the OECD through our Institutional Investors and Long-Term Investment project. And we are ready to partner with the institutional investors community for example through our large Network on Institutional Investors to keep developing new solutions, new theories, new and better policies for better lives.

Thank you very much.