G20 Russian Presidency/OECD High-Level Roundtable on Institutional Investors and Long-Term Investment

Summary Record

28 May 2013, OECD Conference Centre, Paris

This document contains the summary record of the G20 Russian Presidency/OECD High-Level Roundtable on Institutional Investors and Long-Term Investment “From problems to solutions: Policy measures to address constraints in long-term investment” held on 28 May 2013 at the OECD Conference Centre in Paris.

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Summary

High-level government officials, institutional investors, regulators, trade unions and representatives from international organizations as well as the private sector met at the OECD headquarters in Paris on 28 May 2013 to examine the opportunities and challenges in long-term investment at G20 Russian Presidency/OECD High-Level Roundtable on Institutional Investors and Long-Term Investment. The aim of the seminar "From problems to solutions" was to discuss policy measures and initiatives to address the constraints to long-term investment by institutional investors identified by the OECD and G20 as part of work undertaken under the Russian presidency.

The Seminar was opened by **OECD Deputy Secretary General and Chief Economist, Pier Carlo Padoan**, and **Andrey A. Bokarev, Director, Department for International Financial Relations, Ministry of Finance, Russian Federation.**

Mr. Padoan emphasised that traditional sources of long-term investment financing were all facing challenges – including fiscal constraints on government spending and the weak economic outlook proving unfavourable to corporate investment. Looking at alternative sources of finance, the growth of institutional investors (with more than $85 trillion assets in 2011) such as pension funds, insurers and sovereign wealth funds can bring about a larger and more diversified source of long-term financing for investment needs across all sectors of the economy and specifically in key drivers of growth, competitiveness and employment such as infrastructure, real estate, capital equipment, new technology and firms. However, while these institutions are often referred to as natural "long-term investors", they do not always act in this capacity, for a number of reasons. For instance, only a small percentage of the portfolio is allocated to infrastructure, and of this, an even smaller portion allocated to green infrastructure. Mr. Padoan referred to the need for policy incentives for investment in infrastructure by institutional investors. He also highlighted the OECD High-Level Principles of Long-Term Investment Financing by Institutional Investors[1].

Mr. Bokarev, representing the G20 Presidency, explained that the G20 Finance Ministers and Central Bank Governors, at their meeting in Moscow in February 2013, recognized "that long-term financing for investment, including infrastructure, is a key contributor to economic growth and job creation in all countries". He noted the huge potential for institutional investor financing of infrastructure, the obstacles caused by government policies and regulatory instability, and the great opportunity available to formulate and present concrete proposals to G20 leaders. Mr. Bokarev recalled the mandate issued to the OECD in February 2013 to develop high-level principles for long-term investment financing by institutional investors, and thanked the OECD for the efforts so far. He also welcomed the diagnostic Umbrella Report prepared by international organizations (World Bank, OECD, IMF, FSB, UN, UNCTAD and other relevant IOs). The Report identified, among other things, that the availability and composition of long-term investment financing had been affected by a combination of factors, some related to the global financial crisis and cyclical weaknesses in parts of the global economy, and others related to structural factors and/or longer-term trends.

[1] The last session of the day was dedicated to the High Level Principles. See Session 4.

Session 1: Impact of Regulation of Institutional Investors on Long-Term Financing

Panel discussion chaired by ***Adrian Blundell-Wignall****, Special Advisor to the OECD Secretary-General on Financial Markets,* ***Irfa Ampri,*** *Vice Chairman of Fiscal Policy Agency for Climate Change Financing and Multilateral Policy, Ministry of Finance, Indonesia;* ***James J. Donelon****, President, National Association of Insurance Commissioners, USA;* ***Martin Merlin****, Head of Financial Services, DG Internal Market, European Commission;* ***Angelien Kemna****, Chief Investment Officer, APG, the Netherlands;* ***Konstantin Ugryumov****, President, National Association of Pension Funds, Russian Federation, and* ***Jean-Pierre Jouyet****, CEO, Groupe Caisse des Dépôts, France*

Mr Blundell-Wignall launched the session with some evidence on the drivers of long-term investment by corporations, based on recent OECD research. He highlighted how the low interest-rate environment and the general uncertainty over growth prospects and future policy developments was leading companies to increase leverage in order to buy back shares and increase dividends, rather than increase capital expenditure. He also emphasised the need to bring back interest rates to normal levels and to change the business model of banks to promote long-term investment. Mr. Ampri highlighted the critical role of infrastructure for growth in developing countries and the specific initiatives taken by ASEAN countries, such as the recently launched ASEAN Infrastructure Fund. He also welcomed the studies by the OECD and other international organisations on long-term investment issues.

The panel then focused on the impact of regulation of institutional investors on long term financing and the key challenge of how regulatory frameworks and market practices can be adapted to facilitate institutional investors' role in less liquid markets, particularly in infrastructure and renewable energy. Mr. Ampri noted three important aspects of long-term investment, citing examples from his country's experience: i) the importance of government commitment to long-term investment, ii) the development of financial instruments to support infrastructure investment, and iii) the little tangible observed impact of recent regulatory reform on long-term financing. He also called for regulatory frameworks to reflect the varying development stages of different countries.

The challenges faced by Russian pension funds in infrastructure investment were illustrated by Mr. Ugryumov, notably regulatory limits and lack of expertise. Besides, three main concerns were raised by Ms. Kemna over the possible negative impact of recent financial reforms on long term investments: i) the financial transaction tax, ii) Solvency II, and iii) the initial margin requirement for OTC derivatives by BCBS and IOSCO. Ms. Kemna emphasized that APG and the pension industry is keen to share its perspective on the details and implication of regulatory reform to policymakers. Mr. Merlin underlined the need for a holistic policy approach to regulatory reforms across taxation, accounting and corporate governance, and raised the issues of regulatory uncertainty and lengthy implementation timelines. He also emphasized the importance of calibration to monitor the impact of regulatory reforms and highlighted the OECD's role in advising governments to remove regulatory disincentives to long-term investment. Mr. Jouyet questioned the application of mark-to-market accounting to long-term investment, and underlined the necessity of tackling regulatory arbitrage by companies by implementing globally consistent regulatory frameworks. Finally, the challenges faced by U.S life insurers in infrastructure investment were discussed by Mr. Donelon, from project assessment, monitoring, and documentation to the need for a framework for dispute resolution.

Key messages:

- Policymakers should carefully monitor the total impact of regulation on long-term investment and consider possible adverse effects, such as incentives for pro-cyclical investment strategies by institutional investors.
- There is a need for a comprehensive and integral policy approach including current and new financial markets reforms, tax, accounting and corporate governance. The policy should tackle regulatory arbitrage by companies, and ensure global implementation in a predictable manner, while reflecting the differences in development stages of countries.
- Regulatory reform should be calibrated to the specific risk categories of institutional investors and needs to consider the stage of development of capital markets and the governance and risk management maturity of institutional investors, as well as their expertise in infrastructure investment.

Session 2: Governance of and by Institutional Investors and the Investment Management Chain

*Panel discussion chaired by **Mats Isaksson**, Head of Corporate Affairs Division, OECD; **John Kay**, Economist and Author of the Kay Review of UK Equity Markets and Long-Term Decision Making, United Kingdom**;** **Elizabeth Corley**, CEO, Allianz Global Investors, Germany; **Yngve Slyngstad**, CEO, Norges Bank Investment Management, Norway; **Ross Jones**, President, International Organisation of Pension Supervisors; **Scott Sleyster**, Chief Investment Officer, Prudential, and **Ken Georgetti**, President, Canadian Labour Congress*

A fundamental need in infrastructure and other long-term investment is to ensure that the interests of members, beneficiaries, policyholders and other relevant stakeholders are preserved. One has to reconcile the promotion of long term investment with this objective. This has several implications including the need for institutional investors to rely on proper expertise, and to assure proper governance mechanisms, including in long term performance assessment. Prof.Kay led off the discussion of these topics by reviewing recent equity market trends. He noted that over the decades, equity markets had become increasingly dominated by short-term investors and large asset managers, and corporate governance had forced managements to focus on quarterly earnings instead of investing for the long term. To tackle this issue, he suggested promoting disintermediation in infrastructure investment, by directly connecting long-term investors such as pension funds and insurers with the companies and projects needing finance.

Mr. Isaksson and Ms. Corley discussed in some detail the governance and incentive structure of asset management companies. It was argued that asset management companies could balance the interest of customers and stock holders by using a variety of metrics to measure directors' performances and incentivizing them with deferred compensation for stock holders, while fulfilling the fiduciary duties towards their clients. The case of NBIM in Norway and the role played by equity markets in ensuring corporate governance in the emerging markets were described by Mr. Slyngstad. Mr. Jones addressed concerns over long-term investment by pension funds, including governance, liquidity, uncertainty over infrastructure-related regulation, and short-sighted market trends. Liquidity risk in particular was an important concern in defined-contribution plans as members could switch investment options. A note of caution was raised by Mr. Georgetti against market short-termism, and suggestions made for promoting transparency and accountability, as well as tackling conflict of interests through full disclosure and long-term aligned incentive structures. The session closed with Mr. Sleyster explaining insurers' business models and their management structures, with comments on the need for regulators to focus on cash flows and ALM.

Key messages:

- Greater transparency, along with a shorter investment chain and better alignment between savers and investors' incentives can be a solution to the growing short-termism in capital markets.
- For long-term investment, risk may not merely be defined as volatility, but rather should be based on longer–term metrics.
- Compensation should be in line with the investment horizon, and hence focus on long-term performance.'
- There is a need to rethink the fiduciary duty of institutional investors in order to better inculcate a long-term perspective.

Session 3: Policy Incentives and Instruments for Investment in Infrastructure by Institutional Investors

Panel Discussion chaired by ***Rintaro Tamaki****, OECD Deputy Secretary General, with* ***Claus-Michael Happe,*** *Head of Division, Multilateral Development Banks, Ministry of Finance, Germany and Co-Chair of G20 Study Group on Long-Term Investment Financing,* ***Edoardo Reviglio,*** *Chief Economist, Cassa Depositi e Prestiti,* ***Sharan Burrow,*** *General Secretary, International Trade Union Confederation,* ***Torben Moger Pedersen¸*** *CEO PensionDenmark****,*** ***Mahmoud Mohieldin*** *President's Special Envoy, World Bank Group,* ***Scott Minerd****, CEO, Guggenheim Partners,* ***Scott Dickens,*** *MD, Structured Capital Markets, HSBC.*

This session drew on the rich experiences of the panel members to address the key question of what can be done to encourage more institutional investment in infrastructure. Mr. Tamaki addressed the panel to deliberate on the possible incentives for infrastructure investment, as well as the instruments that would facilitate the participation of institutional investors. Mr. Happe started with initial remarks on the work to be developed through the new G20 Study Group on Financing for Investment, co-chaired by Germany and Indonesia. The pre-conditions required for investment were then discussed, as were the financing structures and vehicles, and the incentives that could raise investment. The panel was unanimous that strong and stable political, legal and economic institutions were paramount for attracting investors. In particular, emerging and developed markets alike need to mitigate political risk and ensure the rule of law and enforcement of contracts in order to provide peace of mind to investors. Mr. Pedersen and Mr. Minerd emphasized that risk-adjusted return on capital (including political risk) was the basis for investment decisions, and discussed the role of credit ratings in signalling which projects were suitable for investment. The role of regulations was analyzed and the sense emerged that the Basel III regulations were probably detrimental to traditional bank lending towards infrastructure, especially in an environment of deleveraging, and that institutional investors and development banks could potentially cover the funding gap.

In terms of instruments, Mr. Reviglio noted the need for further development of financial markets for the long-term, for example long dated currency swaps and local currency bond markets. Despite emerging from the crisis with a bad image, securitization could be both useful and necessary i.a. in the infrastructure sector. It may help to intermediate short term risk into longer durations. There was also consensus on the general merits of credit enhancements from multilateral and supranational bodies. Mr. Mohieldin elaborated on the World Bank Group's efforts in infrastructure finance, including not only loans to governments and to the private sector through the IFC, but also through thought leadership and the encouragement of pension fund investments in Chile and other countries.

Mr. Reviglio highlighted the need to consider the different phases of infrastructure projects and their associated risks. Each phase may need special financing actors, rules and instruments, with banks taking care of the construction phases while the operation phase may be financed via capital markets and institutional investors. Mr. Dickens agreed, and added that the European Investment Bank's Project Bond Initiative was a welcome development that would facilitate the financing of key Greenfield infrastructure projects by institutional investors. Another important aspect of infrastructure projects highlighted by Ms. Burrow was the need for 'greening' such projects. She explained how the green economy was a major generator of employment while also contributing to sustainable development. She advocated a 5% allocation to green investments by institutional investors.

Cross border investment could be encouraged further by clarifying the regulations on withholding taxes, while encouraging the development of the financial markets for currencies and interest rate swaps. One note of caution however emerged that while credit enhancements and incentives were useful in kick-starting projects, it was vital to estimate demand properly and fix tariffs transparently in order to allow investors to assess a project on its own financial merits. A permanent risk must be reflected in the risk premium.

Key messages:

- Strong institutions and stable policy environments are vital and governments need to ensure these as preconditions for investment.
- Financial markets have a role to play through securitization, long dated bonds and swaps, and foreign exchange markets.
- Credit enhancements in the form of guarantees from national or supranational bodies can play an important kick-start role in driving infrastructure investment.
- Consider risk segregation in the different phases of project, i.e., construction, development and operation.

Session 4: High-Level Principles of Long-Term Investment Financing by Institutional Investors

*Panel Discussion chaired by **André Laboul**, Head of Financial Affairs Division, OECD, **Richard Carter**, Director of Business Environment, Department of Business, Innovation & Skills, United Kingdom, **Donald Raymond**, Chief Investment Strategist, Canada Pension Plan Investment Board, **Lim Chow Kiat**, CIO, GIC Singapore, **David Taliente**, Head Europe, Oliver Wyman, **Peter R.Fisher**, Senior MD, Blackrock Inc, **Hubert Penot**, CIO EMEA, MetLife, **Scott Kalb**, Executive Director, Sovereign Investor Institute.*

The last panel discussion of the day was focused on the High-Level Principles of Long-Term Investment Financing by Institutional Investors, developed by the OECD for the G20. André Laboul introduced the work undertaken by the new OECD Task Force on Institutional Investors and Long Term Financing (open to all OECD, G20, FSB and APEC members) which is expected to deliver the High Level principles for the July G20 Finance meeting and then the G20 Leaders Summit in September. He also thanked the seminar participants for their contributions during the public consultation process and commented on the latest work on the principles that had been incorporated into the fifth version of the draft of the principles. Each of the panel members was familiar with the principles and unanimously welcomed the OECD's initiative on the topic. They congratulated OECD on drawing on its convening power to come up with a high-quality document which could serve as guidelines across countries. Mr. Lim noted that while the principles reflected the existing consensus in several areas, they also did provide new direction. Others opined that Principle 1 on the pre-conditions for long-term investment was indeed most important, while Mr. Fisher urged for Principle 3 to apply the more stringent test of acting as a fiduciary rather than the original prudent person test, which would be more demanding of asset managers. He also felt that pension funds and insurance companies could tolerate short-term volatility, their supervisors could afford to take a different view of long-term investing from banking supervisors. Mr. Taliente recommended that regulators should follow the OECD's example and frame high-level principles rather than detailed rules, and let the private sector make its own assessment. But Principle 5 was right to note that development finance institutions could play a key signalling role by backing the right projects.

Besides commenting on the principles, the panellists took the opportunity to present insights from their diverse experiences. Mr. Raymond highlighted principle 1 saying that in his experience, the main obstacle to infrastructure investment was the absence of an adequate and stable institutional and regulatory framework supporting private sector participation in infrastructure projects. Mr. Carter observed that long-term investment was not an end in itself for institutional investors, and that there was often a mismatch between their needs and the needs of the economy. This made it important for the financing structures of long-term investment projects to be designed to suit the needs of investors. Mr. Kalb emphasized that long-term investment from institutional investors did not mean provision of free capital; instead it implied that investments could be held for longer without mark-to-market pressures. But returns do matter in the end, and a transparent and predictable regulatory and tax environment is critical. Yet, institutional investors can afford to be counter-cyclical and invest actively during economic downturns. Mr. Penot presented the life insurer's point of view, saying that the key drivers for investment decisions stem from asset and liability matching, predictability of cash flows and the ability to properly assess the risks involved. As a consequence, fixed income investment grade assets tend to be best suited to meet these objectives. Furthermore, Mr Penot emphasized the need for predictable rule of law, enforcement of creditors' rights, and a stable environment for regulated sectors as key preconditions for long-term investment decisions. Finally, Mr Penot noted that in order to grow life insurers' investments in European long-term assets, the capital charges associated with these investments under the Solvency II framework need to be re-worked.

Key messages:

- Long term financing should be seen as the means to an end and should be designed for the ultimate users of any service, and not necessarily the financial intermediaries.
- It is the role of governments to match the needs of their economies with the needs of institutional investors.
- LTI can take many forms besides infrastructure (i.e. equipment manufacturing, real estate).
- LT investing entails active ownership and value investing in private and public markets, and tends to be countercyclical.
- The OECD High-Level Principles provide a key input into the development of a sound policy environment for guiding long-term investment.
- The OECD is to set up a formal consultative network of institutional investors in response to the success of the public consultation process for the High Level Principles.

Conclusions: G20 and LT Investment – Next Steps

***Ksenia Yudaeva**, Russian G20 Sherpa and Chief of the Russian Presidential Experts' Directorate, and **Chris Barrett** Ambassador and Permanent Representative of Australia to the OECD*

*Closing address: **Rintaro Tamaki**, Deputy Secretary General OECD*

The seminar ended with a short discussion of avenues for the next steps on G20 and long-term investment under the current Russian G20 presidency and the next one in 2014 to be chaired by Australia. **Ms. Ksenia Yudaeva** highlighted the reasons for the importance of the long-term investment work carried out under the Russian presidency. She remarked that it was critical to convert global savings into long-term investment, and hoped that the High-Level Principles would be adopted widely and help achieve this objective. **Mr. Chris Barrett** thanked the OECD and the Russian presidency of the G20 for the work done so far, which presents a credible pipeline for further development under the upcoming Australian presidency of the G20. He also referred to the need for a pipeline of well-designed investment projects to attract investors.

Mr. Rintaro Tamaki closed the seminar summarizing that multiple barriers needed to be overcome in order to unleash the potential of long-term financing by institutional investors. This is why the "High Level Principles of Long-Term Investment Financing by Institutional Investors" are only the beginning of a long process in understanding more deeply the needs of institutional investors, while at the same time protecting the interests of their fiduciaries.

In order to better understand the impact of the factors identified, more analysis and research is needed. The OECD has produced substantial work on long-term investment (including through its recent project on institutional investors and long-term investment[2]), which was presented at the seminar along with the latest research and policy analysis. As requested by the G20, the OECD will monitor institutional investors and carry out in-depth analysis of a variety of policies and market-based incentives to facilitate long-term investment[3]. The OECD also plans to follow-up the development of the High-Level Principles with practical work on effective approaches and good practices to implement the Principles. Other areas of focus for the OECD will be on how to improve policy frameworks for private investment in infrastructure through, for example, the new Policy Guidance for Investment in Clean Energy Infrastructure, or to identify best practices to address policy obstacles to foreign direct investment in infrastructure.

Ultimately, unleashing long-term financing for investment is crucial for putting economies back on a more sustainable and dynamic growth path. The OECD is committed to delivering on this agenda, working hand in hand with the G20 and the Russian Presidency.

[2] For more on the OECD Project launched in 2011 please see www.oecd.org/finance/lti

[3] In February 2013 in Moscow, the G20 Finance Ministers and Central Bank Governors mandated the OECD together with other relevant IOs, to provide analysis of different government and market-based instruments and incentives used for stimulating the financing of long-term investment government and market-based instruments and incentives used for stimulating the financing of long-term investment, as well as a survey report on pension funds' long-term investments.

Appendix: List of Background Documents

1. "Long-Term Investment Financing for Growth and Development: Umbrella Paper", February 2013.[4]
2. "The Role of Banks, Equity Markets and Institutional Investors in Long-Term Financing for Growth and Development", Report for G20 Leaders, February 2013, OECD Publishing.
3. Inderst, G. and Della Croce, R., (2013), "Pension Fund Investment in Infrastructure: A Comparison between Australia and Canada", *OECD Working Papers on Finance, Insurance and Private Pensions*, No.32, OECD Publishing.
4. Blundell-Wignall, A. and Roulet, C, "Long-term investment, the cost of capital and the dividend and buyback puzzle", *OECD Journal: Financial Market Trends*, Volume 2013 – Issue 1.
5. Blundell-Wignall, A. and Atkinson, P, "Deleveraging, Traditional versus Capital Markets Banking and the Urgent Need to Separate and Recapitalise G-SIFI Banks", *OECD Journal: Financial Market Trends*, Volume 2012 – Issue 1.
6. Severinson, C. and Yermo, J. (2012), "The Effect of Solvency Regulations and Accounting Standards on Long-Term Investing: Implications for Insurers and Pension Funds", *OECD Working Papers on Finance, Insurance and Private Pensions*, No. 30, OECD Publishing.
7. Isaksson, M. and Çelik, S. (2013), "Who Cares? Corporate Governance in Today's Equity Markets", *OECD Corporate Governance Working Papers*, No. 8, OECD Publishing.
8. "G20/OECD Policy Note on Pension Fund Financing for Green Infrastructure and Initiatives", OECD Policy Note, June 2012, OECD Publishing.
9. Kaminker, C. and Stewart, F., (2012) "The Role of Institutional Investors in Financing Clean Energy", *OECD Working Papers on Finance, Insurance and Private Pensions*, No. 23, OECD Publishing.
10. OECD (Forthcoming Q3 2013). "Institutional Investors and Green Investments: Healthy Scepticism or Missed Opportunities"
11. OECD Task Force on Institutional Investors and Long-Term Financing, "Draft High-Level Principles of Long-Term Investment Financing by Institutional Investors", May 2013

[4] Presented at the Meeting of the G20 Ministers of Finance and Central Bank Governors, February 2013, Moscow, Russia. Prepared by World Bank staff based on input from the staffs of the Organization for Economic Cooperation and Development, International Monetary Fund, UNCTAD, UN-DESA, World Bank Group, and the Financial Stability Board.