Working Party on Private Pensions

FUTURE WORK ON LONG-TERM INVESTMENT FINANCING

1-2 December 2014

This document is circulated for discussion under the agenda of the WPPP meeting to be held on 1-2 December 2014.

Delegates are invited to provide feedback on the proposed future WPPP work on long-term investment financing.

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JT03366940

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FUTURE WORK ON LONG-TERM INVESTMENT FINANCING

1. The purpose of this note is to begin specifying OECD work on long-term investment financing for 2015, based on directions outlined in the IPPC Programme of Work and Budget\(^1\) and in view of broader OECD and global priorities. Delegates will be invited to provide comments on the note following the meeting, in addition to providing feedback on a planned presentation from the Secretariat at the meeting.

Background

2. Long-term investment is a key contributor to growth, job creation and stability. It contributes to OECD member priorities, including fostering inclusive growth and environmental sustainability, and is a core part of the OECD Programme of Work, for both the Committee on Financial Markets and Insurance and Private Pensions Committee. It is also a key element of the OECD’s New Approaches to Economic Challenges (NAEC) initiative as well as of G20 and APEC workstreams and priorities. As such, it is an important component of several Key Partners’ policy work.

3. The OECD is the leading organisation in the international analysis of issues related to private long-term investment financing. This applies in particular to the role of banks, corporate financing, FDI and institutional investors. The OECD is leading international policy analysis and standard setting on the role of institutional investors in LTI, but is also developing several other projects related to the financing of LTI including, for instance, a multiyear project on the analysis of market-based and governmental initiatives and instruments promoting long-term investment financing.

4. G20 Finance Ministers and Central Bank Governors gathering in October this year in Washington and in Cairns in September, recognised work on long-term investment produced so far by international organisations (FSB, IMF, OECD, UN and WB). Additional work to be undertaken in the upcoming months was also identified. The OECD was called upon to continue to lead an important part of this agenda through the G20/OECD Taskforce on Institutional Investors and Long-term financing.

5. The OECD Project on Institutional Investors and Long-term Investment (OECD Long-Term Investment project [www.oecd.org/finance/lti](http://www.oecd.org/finance/lti)) and the newly established Network on Institutional Investors and Long-Term Investment (the Network; see below) will play a key role in supporting this agenda. This project aims to facilitate long-term investment (LTI) by institutional investors such as pension funds, insurance companies, and sovereign wealth funds, addressing both potential regulatory obstacles and market failures. The goal is to improve the data, information, and analysis on long-term investing, helping institutional investors and policy makers to better understand the opportunities and challenges in the LTI space.\(^2\)

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\(^2\) The scope of the project covers long-term investment intended as: i) ‘patient’ capital allows investors to access illiquidity premia, lowers turnover, encourages less pro-cyclical investment strategies and therefore higher net returns and greater financial stability; ii) ‘engaged’ capital encourages active voting policies, leading to better corporate governance; and iii) ‘productive’ capital provides support for infrastructure development, green growth initiatives, SME finance etc., leading to sustainable growth. See [www.oecd.org/finance/lti](http://www.oecd.org/finance/lti)
Recent OECD work on long-term investment financing

6. Recent OECD deliverables to G20 Finance Ministers and Central Bank Governors on 20-21 September 2014 encapsulate the main elements of OECD efforts over the past year. Outputs included the following:

- **Effective approaches to support implementation of the G20/OECD High-Level Principles on Long-Term Investment Financing by Institutional Investors**: Following the adoption of the G20/OECD High-Level Principles in September 2013, which provide recommendations for policies conducive to higher levels of long term investment, efforts have been focused on identifying operational and effective approaches to facilitate the implementation of these policy principles and unlock finance for long-term investment.

These approaches, based on in-depth surveys, seek to provide examples of successful and sometimes innovative practices in such areas as regulation, governance, data collection and the development of financing instruments and vehicles for funnelling institutional investment into long-term investments. The G20/OECD Task Force on Institutional Investors and Long-term Financing has developed the first set of Effective Approaches to support implementation of the High-Level Principles, covering Principles 3 (Governance of institutional investors, remuneration and asset management delegation), 5 (Financing vehicles and support for long-term investment and collaboration among institutional investors) and 7 (Information sharing and disclosure) in their entirety and selected sub-principles of Principles 1 (Preconditions for long-term investments) and 2 (Development of institutional investors and long-term savings).

- **Checklist on long-term investment financing strategies and institutional investors**: The OECD has also developed practical tools, such as a voluntary checklist, to assist governments in self-assessing their support for long-term investment financing. This checklist will make it possible for countries to identify the strengths and weaknesses of their policy framework in such areas as regulation and governance or the development of long-term savings and local capital markets.

- **Analytical work on government and market-based incentives for long-term investment financing**: Work continues on a major G20/OECD project on the analysis of government and market-based incentives for long-term investment financing. As part of this project, a taxonomy is being developed that would outline the wide range of options available to institutional investors for accessing the asset class, focusing on new forms of investment (both equity and debt) and risk mitigation mechanisms. As an outcome of this analysis, two reports have been circulated to G20 Finance Ministers and Central Bank Governors (see Annex):
  - “Pooling of Institutional Investors Capital – Selected Case Studies in Unlisted Equity Infrastructure”;
  - “Private Financing and Government Support to Promote Long Term Investments in Infrastructure”.

- **Global dialogue**: The OECD organized in Singapore on 4 June 2014 a G20/OECD High Level Roundtable on Institutional Investors and Long Term Investment (*From solutions to actions: implementing measures to encourage institutional long-term investment financing*), co-organised

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3 See report Prioritisation of Work to Inform Effective Implementation Approaches of G20/OECD High Level Principles on Long-term Investment Financing by Institutional Investors, which outlined agreed work priorities: [https://www.g20.org/sites/default/files/g20_resources/library/OECD%20Prioritisation%20of%20work%20to%20inform%20effective%20implementation%20approaches.pdf](https://www.g20.org/sites/default/files/g20_resources/library/OECD%20Prioritisation%20of%20work%20to%20inform%20effective%20implementation%20approaches.pdf)
with the G20 Presidency and the Singapore Ministry of Finance, a summary of which was circulated to G20 Finance Ministers and Central Bank Governors. The event gathered together delegates from the G20/OECD Taskforce, members of the G20 Investment and Infrastructure Working Group (IIWG), B20 sherpas and representatives, international organizations and senior representatives (CEOs/CIO) from institutional investors including the largest SWFs, pension funds and insurers as well as asset managers and banks. The topic of long-term investment financing was also discussed within the annual OECD/ABDI Tokyo Roundtable held in March 2014.

The OECD has supported APEC work on strengthening cooperation on infrastructure investment and financing, which was identified as an important policy theme for the APEC Finance Ministers’ Meeting (FMM) in 2014 under the current Chinese presidency. As part of the work under this theme, the Ministry of Finance of the People’s Republic of China hosted an international seminar on “Mobilizing Long-Term and Stable Financing for Infrastructure Development in the Asia-Pacific Region” in Dalian, China on 26-27 June 2014. The event was co-organised by the OECD and addressed in turn issues pertaining to (i) Managing Risk and Return of Long-term Infrastructure Investment, (ii) The Challenges of Infrastructure Investment—From Investors’ Perspective, (iii) PPP Center/Unit’s Role in Infrastructure Development, and (iv) Cultivating Financial Markets to Promote Infrastructure Development.

7. While not a deliverable for the G20, work is underway on a project on the investment strategies of insurers and long-term investment financing, being conducted by the Insurance and Private Pensions Committee. This project will include a data collection exercise on the investment portfolios of selected major insurers, similar to the now ongoing annual exercise to collect data on the portfolio investments of large pension funds. This current micro data collection on LTI by pension funds will be enlarged to insurance companies in order to provide a unique set of information. The OECD is coordinating the collection of data with other international organisations (such as the IMF, BIS, ECB, FSB) to ensure synergies and to avoid duplication. The survey on pension funds was presented to G20 Finance Ministers and Central Bank Governors at their October 2013 meeting in Washington.

8. Understanding the activities and role of institutional investors in financing long-term investment helps to support the collection of data and the development of analysis on issues relating to financing. The OECD Secretariat has consequently worked closely with the private sector and in particular with institutional investors through the OECD LTI project. More recently the OECD has officially launched a new large Network of investors engaged in the long-term investment business, with the objective of developing further consultation and dialogue.

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4 See link: APEC/OECD Seminar Dalian 2014
Engaging the private sector: the new Network on Institutional Investors and Long-Term Investment

A Network on Institutional Investors and Long-Term Investment has been established to support future work on the contribution of institutional investors to growth and development and on the long-term investment issues. This network would build on the existing database of contacts. Through the LTI project the OECD has been engaging with some of the largest investors across the world, creating a network of institutions actively collaborating on our research and participating in events and a database with over 1,500 contacts.

The OECD will build and maintain a dedicated online repository of classified documents, reports and tools that investors, industry experts, academics, multilaterals and policy agencies have already developed in areas related to long-term investment. The members of the network will be regularly invited to provide comments and contributions to OECD and related G20 and APEC work and will be kept informed of relevant developments.

The Network could benefit from the creation of an interactive web portal allowing for on-going discussion on the topic amongst the policy making and industry communities. Building on this portal, in a second phase the OECD could launch a community website and a forum on long-term investment themes, to become a central hub to allow investors, providers and policy makers to interact directly.

The Network will also facilitate the surveillance function of the IPPC and CMF, providing a good opportunity to monitor the financial market-based and governmental innovations introduced recently to address major societal challenges.

**Expected work on long-term investment financing in 2015**

9. As outlined in the IPPC Programme of Work, future IPPC work on LTI will be broader in scope, enlarged to capture all relevant governmental and private financial institutions/vehicles as sources of financing, including in particular banks and capital markets beyond institutional investors, providing better data, more in-depth analysis and related policy recommendations. This work will be carried out in conjunction with the Insurance and Private Pensions Committee.

10. In particular, work is expected to include:

- **Further work on effective approaches**: The G20/OECD Task Force on institutional investors has been invited by G20 Finance Ministers and Central Bank Governors to deliver the remainder of the effective approaches to implement the G20/OECD High-Level Principles by the 2015 Leaders’ Summit. Regarding Principle 4 (Financial regulation, valuation and tax treatment), there will be close cooperation with the FSB and international standards setting, as outlined in an agreed Roadmap.\(^5\)

- **Checklist**: Building on the Checklist on long-term investment financing strategies and institutional investors delivered for the G20 in October 2014, an aggregation exercise will be finalised by early 2015 in which responses to country self-assessments against the checklist - to be provided on a voluntary basis - will be aggregated into a survey report. A separate, joint WBG/OECD checklist on project preparation will also be delivered in 2015.

- **Analytical work on LTI financing – the role of bank financing, debt and equity markets**: Consistent with ongoing work on the analysis of government and market-based instruments and incentives to stimulate long-term investment finance, and in line with directions outlined in the CMF PWB, efforts could be made to strengthen analysis of LTI financing, with a broader scope to include all relevant forms of financial intermediation. Such work will not only help to deepen

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OECD analysis of LTI financing issues but also serve to support G20 efforts in 2015 to identify where advances can be made with financing instruments, which could further promote financing for infrastructure and SMEs. There may be a possibility to exploit synergies in the work of the CMF on SMEs and LTI financing in 2015. Good practices could emerge from this work, including on National Strategies to promote private financing of long-term investment (building also on the results of the checklist exercise mentioned above).

This work could include the following elements:

- A taxonomy of private financing mechanisms for LTI, with a focus on infrastructure, along with risk mitigation mechanisms (instruments and incentives) the public sector can use to leverage financing in infrastructure in particular targeting institutional investors (for example guarantees, grants, fiscal incentives, etc.). This would continue and build on existing work on government and market-based incentives for long-term investment financing.

- Examination of the changing nature of banks and their role in financing long-term investment. Currently, infrastructure finance is dominated by corporate direct equity investments and bank loans. Banks will remain important financiers, in particular in the early stages of new projects. However, banks, which have mostly short-term liabilities, are not well-placed to hold long-term assets on their balance sheets for an extended period of time. A much broader group of investors may thus need to be targeted to address the mix of long-term investment financing needs (i.e. the “right siting” of capital).

- Examination of the role of debt capital markets in funding long-term investment. Debt markets could be an important source of funding for mature infrastructure, given the long-term, stable, essential and inflation-linked nature of the cash flows. Pension funds are the natural buyers of long-dated inflation-linked assets to finance long-term capital expenditure to match their liabilities. In the U.S., Europe, and Latin America, initiatives targeting institutional investors have been launched to promote infrastructure investment via debt markets.

- Examination of the role of securitisation. The securitisation of infrastructure bank loans seems to provide an opportunity to diversify risks in infrastructure investing. CMF work developed to analyse securitisation for SMEs will assist in the evaluation of the role of securitisation and other types of capital market instruments for long-term investment.

- Continued global dialogue: The OECD is expected to organise, under the Turkish G20 presidency, a G20/OECD High Level Roundtable on Institutional Investors and Long Term Investment, continuing the practice called for under the Russian presidency in 2013 and the Australian presidency in 2014. Further cooperation with APEC is also expected as well as with Key Partners (Brazil, China, India, Indonesia, South Africa), which are all members of the G20, and with key emerging market economies in the South East Asian region. A special extra full day session on long-term investment financing is expected to be organised as part of the forthcoming Tokyo Roundtable in early 2015.

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7 http://www.apec.org/Meeting-Papers/Ministerial-Statements/Finance/2014_finace.aspx
11. In addition, further work could be envisioned, resource permitting:

- **Building a stronger database in order to produce strong, evidence based analysis**: Strengthening of data foundations will allow development of selected analysis of market developments related to LTI themes, as for instance the impact of prolonged low interest rates on institutional investors' investment strategies; impact of new regulations and financial valuation standards, investments in alternative asset classes and emerging markets by institutional investors, or the impact on real economy (infrastructure and green investment). In order to identify the flows and to better capture the underlying trends in asset allocation and investment strategies of institutional investors, as a part of the LTI project, the OECD, under the aegis of the WPPP, launched surveys in 2010, 2011 and 2013 of individual pension funds both within and outside of the OECD that are amongst the largest in their respective country.

- **Infrastructure as an asset class - the promotion of international infrastructure data collection**: Governments and regulators could, where appropriate and needed, strengthen formal requirements to provide consistent information on investments by pension funds in infrastructure, following internationally agreed definitions. This would allow for future monitoring on an international basis. This is necessary for pension funds themselves to have the necessary data to analyse the performance of these investments and the confidence to then make allocations. It is also necessary for regulators and policy makers to be able to understand and monitor such allocations in order to be able to make appropriate policy responses. Despite its importance, there is little consistent data available on the performance of infrastructure.

12. Other work on long-term investment financing could, resource permitting, be pursued, consistent with proposals advanced in the 2014-15 IPPC PWB. Furthermore, the IPPC will be expected to play a leading role in some other OECD workstreams on long-term investments as well as possible global workstreams, such as the development of national strategies on infrastructure investment, of which financing would be a component.

Delegates are invited to provide feedback in writing to the Secretariat (Raffaele della Croce: raffaele.dellacroce@oecd.org; and Stephen Lumpkin: stephen.lumpkin@oecd.org) on the above proposed LT financing work for 2015 by 19 December.
ANNEX

OECD WORK ON THE ANALYSIS OF GOVERNMENT AND MARKET-BASED INSTRUMENTS AND INCENTIVES TO STIMULATE LONG-TERM INVESTMENT FINANCE

This OECD lead project was called by the G20 Finance Ministers and Central Banks Governors in 2013 and was included in the work plan of the G20 Study group on financing for investment, endorsed by the G20 Leaders at their 2013 Summit. The project has then been developed in 2014 under the G20 Australian presidency through the work of the IIWG and the G20/OECD Taskforce on LTI.

As part of the project, and based on work undertaken for the OECD Institutional Investors and Long-Term Investment Project (www.oecd.org/finance/lti), three reports have been produced in 2014 (see box below). These papers benefited from comments from the G20 IIWG, from the G20/OECD Taskforce on Institutional Investors and long-term financing and from the following OECD bodies: the Committee on Financial Markets, the Insurance and Private Pension Committee and the Working Party on Private Pensions.

Papers developed for the analysis of government and market-based incentives for long-term investment financing:

- The paper “Pooling of Institutional Investors Capital –Selected Case Studies in unlisted equity infrastructure” (referenced in the G20 communiqué in April 2014) firstly looks at the evolution of private institutional investment in infrastructure and examines how the market has developed. An analysis of the various investment vehicles is carried out with a snapshot of the growth experienced in the market. The infrastructure investor universe is then categorised according to the specific method that is utilised for investing in infrastructure. The second part of the paper introduces the new initiatives that have been developed in response to the drawbacks and early inefficiencies, highlighting specific case studies of co-investment platforms, government-led initiatives and revised unlisted infrastructure funds that are providing opportunities for institutional investors interested in investing in unlisted equity infrastructure assets.

- Another report, Private Financing and Government Support to Promote Long Term Investment in Infrastructure, (circulated at G20 September meetings) includes analysis of the public sector decision to attract private capital focusing on institutional investors; the typical risk profile of an infrastructure asset from the private investor’s standpoint and institutional investor’s perspective of infrastructure investing in the forms of equity, debt and capital markets instruments [comment: the second part is difficult to understand by itself]. Particular attention is given to debt infrastructure vehicles for institutional investors, looking in particular at new forms of debt.

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8 At the meeting in Moscow on 15-16 February 2013, G20 ministers welcomed diagnostic reports by international organizations assessing factors affecting long-term investment financing. At that time, several international organizations were given mandates and the OECD was asked to (see February Communiqué):

- Develop G20/OECD High Level Principles on Long-Term Investment Financing by Institutional Investors, subsequently endorsed by G20 Leaders in September 2013;
- Conduct an annual survey of Large Pension Funds and Public Pension Reserve Funds, circulated in October 2013;
- Prepare an analysis of different government and market based instruments and incentives used for stimulating the financing of long term investment.
infrastructure investments responding to a progressive retreat of banks and to an increased interest by institutional investors for long-term infrastructure investments.

- A third forthcoming report, *Institutional Investors and Sustainable Energy*, will introduce approaches to mobilise institutional investors in green infrastructure. This report will add value to topics already covered and supplement OECD input on infrastructure as a broader asset class, by taking an in-depth look at green infrastructure, focusing on clean energy infrastructure.