Directorate for Financial and Enterprise Affairs

Paris, 18 April 2014

Dear Mr De Crayencour,

I am writing to thank you for your interest to join the OECD project "Institutional Investors and Long Term Investment" over the period 2014-2015. The OECD welcomes private sector stakeholders to join us in this project and we would be delighted to have your organization as one of our strategic partners.

The ultimate goal of our project is 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. In the process, we intend to improve the data, information, and analysis on long-term investing, helping institutional investors better understand the opportunities they face in the LTI space and how their peers have sought to benefit from them. The project will therefore rely on a close cooperation with major investors and other key stakeholders.

As an intergovernmental organisation, we will also engage directly with the authorities responsible for the various policy areas relevant for this project. On institutional investment, expertise and oversight is provided through the OECD Insurance and Private Pensions Committee and the Committee on Financial Markets, working in close coordination with the International Organisation of Pensions Supervisors. The project also benefits from the OECD databases of pensions and insurance statistics and collaboration with an extensive network of institutional investors.

In addition to our member countries, we will seek the close involvement of key non-OECD countries that are part of our Enhanced Engagement process (Brazil, China, India, Indonesia and South Africa). The project should help broaden policy makers' knowledge and understanding of institutional investors' needs and challenges so that – where relevant – supportive legislation and regulation will be drafted and enforced. The project aims to provide policy recommendations at the highest political level.

The project is organized in a series of modules, further described below. The specific outputs for 2014 and 2015 will be confirmed depending upon funding availability. The project has the following three main deliverables:

- Data: building on existing OECD databases to monitor and analyse institutional investors' asset allocation on a micro level (data on assets, flows, performance, etc) with a specific focus on alternative investments such as infrastructure. Data is already being received from more than 80 large institutional investors which on aggregate manage approximately US$ 9 trillion. The OECD will coordinate with other institutions to ensure synergies and avoid duplication in the information requests to be sent to investors;
- Policy Analysis: detailed and practical research on LTI issues (corporate governance, regulation, infrastructure, "green" investment and emerging markets) which will ultimately lead to the formulation of policy recommendations;

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- Events: two types of events: a) operational level events engaging institutional investors and policy makers (governments, regulators etc) on LTI issues (OECD events or in partnership with other organizations); b) high-level policy events to present provisional recommendations and support final recommendations.

For more information on the Project, research published, events organized and engagement in policy discussions (i.e. G20, EC, APEC) in 2012 and 2013, please see the LTI Project Report and the website www.oecd.org/finance/lti.

In addition to existing OECD resources the Project will be funded through voluntary contributions from grants from the business sector and research institutions, government departments and agencies.

We are seeking contributions from each partner for Eur 100,000 for each of the 2 years of the project, covering the period 2014-2015. This will cover, *inter alia*, the following costs: OECD Project management; data collection and analysis; commissioning of internal and external papers; organization of events; production and distribution of reports; website development; and Project-related travel.

Your contribution to this discussion would be very valuable and we thus hope you will be able to participate. Please let us know at your earliest convenience whether you will be able to join us, as a partner or in another form. If you think it appropriate, I would welcome the opportunity of a further meeting to discuss the details of the Project. For further information, please do not hesitate to contact either myself or Mr. Raffaele Della Croce, Lead Manager [Tel: +33 1 45 24 14 11; e-mail: raffaele.dellacroce@oecd.org].

I look forward to future cooperation between the OECD and your organization. As the G20 agenda notes, this is an important topic for policy makers and investors where I hope for fruitful collaboration between our organizations.

I look forward to hearing from you.

Yours sincerely,

André Laboul
Head of Financial Affairs Division
Directorate for Financial and Enterprise Affairs, OECD

## Project Outputs

Work on the Project will be organised in a series of modules which will be carried out partly in sequence, partly simultaneously:

*Module 1: Data Collection on Institutional Investors and Alternative Investments*

The OECD is the leading international organisation gathering official, national data on institutional investors, including asset allocation, performances, operating costs. The OECD is coordinating collection of data with other international organizations (such as IMF, BIS, ECB, FSB) to ensure synergies and avoid duplication.

Through this data collection exercise, the OECD will be able to disseminate research about best practices and trends in institutional investment, better understand the role and performance of alternative investments (such as private equity, real estate, infrastructure, hedge funds and commodities) from the perspective of institutional investors, and identify the extent to which institutional investors engage in long-term investing. While the quantitative and qualitative evidence collected through the survey will be of prime value to the ultimate investors, it will also be used to inform regulators and other policy makers in order to help them better understand the operation of institutional investors in different countries and produce appropriate regulation.

*Module 2: Infrastructure Investment & Green Investment*

Despite the theoretical ideal match between a large source of capital and an asset class in need of investment, the uptake of institutional investors has been slow. This has been partly due to bad experiences with early investments, discontent with the vehicles used to access infrastructure assets and a lack of government facilitation. Infrastructure investment is complex and requires proper understanding and analysis. Although often considered as one of the alternative investment options, it has specific characteristics. Infrastructure investment related to a transition to a low-carbon climate resilient economy (i.e. renewables and clean tech, water, etc.) presents further opportunities and challenges. The OECD has identified several areas of further research and activity related to institutional investors and infrastructure and green investment.

Shortage of objective information and quality data make difficult to assess infrastructure transactions and understand the correlation with other sectors, especially for new investors less familiar with the characteristics of the investment. This work would be based on specific data collection already undertaken by the OECD and new statistical analysis proposed for the project. This module will also focus on the financial instruments and vehicles, regulatory and institutional conditions that can make infrastructure investment attractive for pension funds and insurers.The analysis would consider models for infrastructure adopted by selected countries and new models currently in discussion, both on the equity and fixed income side, in OECD and G20 countries.

*Module 3: Regulation*

This module will analyse the impact of regulation and valuation standards on institutional investors' investment strategies. One major focus of the research will be the role that mark-to-market, risk-based funding and solvency regulations have played in driving investments away from riskier asset classes and what impact further moves in this direction (e.g. Solvency II and IORPs II in Europe) will have on investors' appetite for assets such as equities, real estate, venture capital and infrastructure and in the counter-cyclical behaviour of institutional investors. The report will provide (i) a theorical framework for understanding solvency risk and investment strategies, (ii) a comprehensive comparison of the different regulatory approaches observed across countries, (iii) a practical assessment of the magnitude of the changes happening or to yet to happen in investment strategies as a result of regulatory reforms.

Analysis could be envisaged to address the question of alignment of incentives in the asset management industry, looking at how the design and review of mandates, fees and benchmarks, and performance evaluations affect holding periods and the scope for long-term investment. The research would draw on the statistical questionnaire developed by the OECD for large institutional investors to which further questions could be added on various aspects of investment mandates. Ultimately, the report would seek to draw out lessons and suggest possible actions (including regulatory and supervisory guidance) to ensure a better alignment of interests and investment horizon between asset managers and asset owners.

*Module 4: Corporate Governance*

This module will look at internal governance at institutional investors level and the role of institutional investors in promoting good corporate governance. Informed, knowledgeable investors are the basis for good governance and a proper alignment of incentives. Raising the bar of governance among institutional investors is essential to create the right incentives among asset managers to better look after the long-term interest of beneficiaries. Over the longer term, well-governed institutional investors are expected to generate higher returns (adjusted for risk and expenses) than poorly governed funds.

The nature of institutional investors has evolved over the years into a complex system of fund management companies with their own corporate governance issues and incentive structures. Investment chains have also lengthened increasing the distance between the final beneficiary and an investment in an enterprise. Investment strategies have also evolved with passive investing through indices and exchange traded funds becoming more important so as to lower transaction costs and increase returns to beneficiaries. Against this background, the old question of investor oversight of company boards needs to be examined.

Not all the arguments in this debate relate to good corporate governance *per se,* but to their potential for underpinning growth and development, and addressing other issues such as environmental and social goals. However, there is a close relationship between good corporate governance that promotes company performance and accountability, and addressing these broader issues.

*Module 5: Emerging Markets*

In most emerging countries, institutional investors are still largely underdeveloped. Governments need to establish the appropriate regulatory, supervisory and tax frameworks for such investors to develop. One of the priorities for emerging countries is to create a financial system that can provide the finance needed for its development, and especially for infrastructure development. Among the biggest challenges in the infrastructure sector is the absence of long-term financing which could fund large scale projects. Sources of non-traditional infrastructure financing could if appropriately utilized provide the needed long-term capital.

Local financial markets – banks, pension funds & insurance sector, and capital markets – offer a number of potential advantages if they can be tapped. International experience in countries such as Mexico and Chile suggests that institutional investors and, in particular, pension funds assets have been instrumental to the growth of the corporate bond market, and, in turn, to the provision of development finance.

Also the possibility of channeling the largest institutional investors and excess global savings toward infrastructure investment is often mentioned. Some of the largest pension funds and SWFs are actively investing in emerging markets. Incentives and assistance for international institutional investors to become more involved in funding infrastructure projects globally can be put in place.

This module would look at challenges, weaknesses and strengths of different mechanisms to mobilize local and foreign financing from institutional investors in developing countries. Seminars to be co-organized with local governments are planned in Indonesia, India, Mexico, Brazil, China and South Africa.

## Proposed project timetable and tentative deliverables[1]

| Date | Event | Output |
|---|---|---|
| Q1/Q2 2014 | • **OECD LTI specific event:** OECD/APG/RiskLab technical workshop on Pension Fund Regulation and Long Term Investment, April , Amsterdam<br>• **OECD LTI specific event:** OECD/ICPM Rotman Long Term Investment Seminar, June, Paris<br>• **OECD LTI specific event:**G20/OECD High Level Roundtable on Institutional Investors, June Singapore (in cooperation with Australia –G20 Presidency) | • Pooling of Institutional Investors Capital: Selected Case Studies in Unlisted Equity Infrastructure –Report to G20<br>• Trends in Global Asset Allocation of Institutional Investors - Report to G20<br>• Infrastructure Financing in Indonesia<br>• Debt Capital Markets for Infrastructure financing |
| Q3/Q4 2014 | • **OECD LTI specific event:** APEC/OECD Seminar on Institutional Investors and Infrastructure Financing June China (in cooperation with China –APEC Presidency)<br>• **OECD LTI specific event:** OECD Annual Institutional Investors Forum, Paris, France (in cooperation with Euromoney/Sovereign Investors Institute)<br>• **Related OECD event:** 2014 OECD/IOPS Global Forum on Private Pensions, Namibia (in association with IOPS) | • Data: Large Pension Funds Survey 2014<br>• Government and Market Based Instruments and incentives to stimulate long term investment finance - Report to G20<br>• The Effect of Solvency Regulation and Accounting Standards on Long-Term Investing<br>• Investment in Real Estate: Lessons for Other Real Estate Assets<br>• Risk-Return Characteristics of Infrastructure as an Asset class - Report to G20 |
| Q1/Q2 2015 | • **OECD LTI specific event:** OECD Seminar on Regulation and Long-Term Investment, Amsterdam, Netherlands<br>• **OECD LTI specific event:** Seminar on Institutional Investors and Infrastructure Financing (in cooperation with Ministry of Finance, Philippines- APEC Presidency)<br>• **Related OECD event:** Annual meeting of Senior PPP Officials, Paris | • Regulation and Long-Term Investment<br>• Insurers as Long-Term Investors<br>• Promoting Debt Capital Markets Solutions for Infrastructure Financing<br>• Sovereign Wealth Funds and Infrastructure Investment |
| Q3/Q4 2015 | • **OECD LTI specific event:** Seminar on Institutional Investors (in cooperation with Ministry of Finance Turkey - G20 Presidency)<br>• **OECD LTI specific event:** OECD Annual Institutional Investors Forum, Paris, France<br>• **Related OECD event:** 2014 OECD/IOPS Global Forum on Private Pensions, (in association with IOPS) | • Data: Large Pension Funds Survey 2015<br>• Insurer Portfolio Investment: Opportunities and Constraints for Long-Term Investing<br>• The Role of Institutional Investors in Corporate Governance and Value Creation<br>• Further research to be defined |

[1] All Project Sponsors and Partners will be invited to attend OECD events specifically designed for the LTI Project. A few selected Sponsors and Partners will be invited to other listed events on related issues. This is a tentative timetable. The specific events/outputs will be confirmed depending upon funding availability, Sponsors' priorities and changes in the international policy agenda.