SUMMARY OF THE G20/OECD/SINGAPORE MINISTRY OF FINANCE HIGH-LEVEL ROUNDTABLE ON INSTITUTIONAL INVESTORS AND LONG-TERM INVESTMENT

OECD REPORT TO G20 FINANCE MINISTERS AND CENTRAL BANK GOVERNORS

September 2015

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This report was submitted to the G20 IIWG meeting in Berlin on 20-21 August 2015, and is now transmitted to the September meeting of the G20 Finance Ministers and Central Bank Governors.

G20/OECD Singapore High-Level Roundtable on Institutional Investors and Long-term Investment

Organised under the aegis of the G20 Turkish Presidency, the OECD and the Singapore Ministry of Finance

28 May 2015, Singapore

Introduction

The G20 Turkish Presidency, the Organisation for Economic Co-operation and Development (OECD) and the Singapore Ministry organised on the 28th of May the G20/OECD High-Level Roundtable on Institutional Investors and Long-Term Investment (the High Level Roundtable). The third High-Level Roundtable, after the Russian and Australian G20 presidency roundtables in 2013 and 2014 was organised this year in Singapore.

The High Level Roundtable is an invitation only event, bringing together selected senior representatives of long-term institutional investors, banks and corporates as well as high-level officials and experts from governments and international organisations. Discussions focused on key themes related to the G20's work this year, including how policymakers and investors can facilitate private sector infrastructure financing, the development of infrastructure as an asset class, issues related to the regulation of long-term investment, and recently launched initiatives such as the G20 Global Infrastructure Hub. This Roundtable contributed to the G20's work on long-term investment financing and the OECD's project on *Institutional Investors and Long-term Investment* (www.oecd.org/finance/lti) *[see appendix for background to the Roundtable and the Agenda for this year]*

Summary record

SESSION I: Role of Capital Markets for long-term Investment. Access to Finance: Financial Instruments for Infrastructure Investment

Speakers noted vast improvements in the willingness of banks to take risks across developed economies. While banks still play a crucial role in financial intermediation for long-term projects, the natural match of long-term real assets with the long-term liabilities of pension funds and insurers should increasingly attract such investors. Shareholders of pension funds are not interested in buying and selling assets, but in long-term profits. The emergence of sustainability and stewardship as components of long-term value has put additional attention on the social role of institutional investors, such as the financing of the transition to a "green economy". The increasing volume of green bonds and sukuk is illustrative of these developments. However, some participants insisted that the fiduciary duty of asset managers must remain the key driver of investment decisions.

At the same time, yields on government bonds remain low and will potentially stay low for an extended period of time, pushing investors towards other asset classes. Infrastructure can offer attractive yields to investors over an extended period of time, while also providing diversification benefits. Competition for high-quality infrastructure assets has intensified, resulting in higher prices and driving down returns. Governments have a range of instruments available to enhance the return of infrastructure assets, but could also support projects through providing technical advice and harmonising regulation across regions and countries.

Moreover, Central banks have been injecting a high amount of liquidity in financial markets. While liquidity remains abundant, only a small fraction of it is channelled towards infrastructure financing due to a series of obstacles.

The lack of bankable projects emerged as a major issue in the discussion. Governments, administrations and project developers have been called upon to join forces with MDBs and other international organisations in order to improve capacity for project preparation. With government finances under pressure in many economies, efficiency of procurement and communication need to be improved to provide a stable and transparent pipeline of projects entailing long-term commitments. Public entities are too often competing with the private sector for viable projects. Privatisation of infrastructure assets provides opportunities in many countries, however governments need to make sure this is done under competitive conditions. Additionally, government should provide a stable regulatory framework conducive for the development of infrastructure businesses.

Speakers said governments should focus on reducing macroeconomic and regulatory risk, while setting the conditions for a competitive market. Limited availability of local currency in some emerging economies has been described as an obstacle, but also as an opportunity to develop derivative markets. Regulatory changes affecting banks and institutional investors also need to reduce uncertainty to avoid unintended consequences for long-term investment. While long-term contracted revenue is interesting to investors, agreements need to be enforceable and transparent. Trust in political commitments to long-term investment plans could be enhanced via a separate treatment of investment in public finances. This would help to avoid a sharp reduction in investments in times of budget consolidation.

Recently introduced financing vehicles such as project bonds, green bonds or sukuk are expected to persist and gain in importance. Panellists noted that there is a need to build expertise and data sources for such investments in order to promote their use. Cooperation between different institutional investors has also been identified as an emerging practice; while duration differences with banks remain, cooperation could be beneficial to both sides.

Finally, as infrastructure remains an opaque market better communication of opportunities to investors and the public would increase exposure. The lack of data and a comprehensive track record of infrastructure investments remains a key challenge. Governments, MDBs and international organisations should share experiences and combine efforts to provide a public database.

SESSION II: Enabling Infrastructure Investment: Addressing the risks

Governments can reduce political influence by developing independent project pipelines, thus reducing uncertainty. Efficiency of procurement and of the approval process can also be enhanced. Innovative instruments can be used to reduce risks. An independent, rigorous cost benefit analysis of all project stages needs to be carried out to ensure sound fundamentals for each project. High quality, credible PPPs will continually attract private investment.

Public instruments to raise project returns and enhance stability of cash flow are not fundamental failures according to speakers and need to be evaluated on project basis. This can be very complex, with important differences between projects. However, to get projects to the market, the creation of an enabling environment should be the priority for the public sector. Contracts need flexibility in order for the public sector to be comfortable and avoiding constant renegotiations.

Governments can also mitigate demand risk by reducing affordability constraints through subsidies. Dedicated institutions across government levels could be useful in providing adequate capacity and a level playing field across countries.

It is important to align incentives for the public and private sector by protecting stakeholders in infrastructure assets, but also by protecting consumers and users. Where the public sector protects investors against downside risk, a surplus in cash flows should be shared with the public, possibly through lower user charges or reduced taxes.

In OECD countries the cost of debt is extremely low, while in emerging countries cost of both debt and equity remain high. Companies are buying back shares instead of investing in productive activities. Panellists explained that the returns on equity do not justify the cost of equity, especially in emerging economies. Moreover, the evolution of global value chains has led to an outsourcing of investment risks to emerging markets. The high importance of State owned Enterprises in some developing economies, specifically in the infrastructure sector, heightens exposure to political risk. Emerging markets also tend to have higher capital controls, an obstacle to foreign investment.

Short-termism remains an important issue. Investors tend to disfavour long-term investments because they are seen as riskier; instead focusing is on short-term rents and on risk adjusted performance relative to established benchmarks. Institutional Investors however are looking for long-term investments, creating a theoretical match.

The role of pension funds could also be evolving. At a time when demographic change in most developed countries will lead to lower public pensions for future generations, investing institutional retirement savings to finance long-term projects for the real economy, particularly social infrastructure, might be an option to provide protection to future generations.

Low interest rates in advanced economies could put pension funds and insurance companies under pressure and push them towards alternative assets with a higher yield. This is reflected in evolving asset allocations, where the share of equity is rising. Panellists raised concerns about the lack of data on outstanding bonds and the structure of instruments involved in alternative investments. The intensifying control of commercial bank activities might lead to the accumulation of risks through alternative financial intermediaries, where it is more difficult to track.

SESSION III: Infrastructure as an Asset Class: Understanding Institutional Investors potential and Bridging the Data Gap

Speakers have highlighted the caveats of existing infrastructure indices and datasets, as well as the important need to address the lack of data on infrastructure assets. The benefits would not only be for investors and the industry gaining access to quality benchmarks and track records for portfolio construction. Regulators and governments would also benefit from a data foundation from which to provide better regulation and more efficient concession projects.

The panellists explained infrastructure to be a heterogeneous asset class, and thus inherently difficult to unanimously define as a basis for data collection. Different approaches are being taken to classify infrastructure assets, including according to industrial sector, investment profile or economic nature of the service. Aggregating data across different types of projects might not provide the desired insight; a certain level of segmentation has to be reached. The difference between the asset and the contract as object of evaluation has been stressed. In project finance, ownership of infrastructure usually remains with the public authority, so the contract reached between private and public sector as well as regulation might be driving the performance and thus be the focus of investors. Project finance does not cover all infrastructure investments, however SPV's characteristics are specific and might change little over time, which would allow for a long-term benchmark.

Existing empirical work and industry indices have been discussed. Often concentrated on certain geographies due to limits in data availability, they provide interesting insights. Characteristics often associated with infrastructure are inflation linked returns, long duration, lower default risk, high recovery rate and stable and predictable cash flow allowing high leverage. Differences in geographies persist, notably a longer recovery rate in emerging markets, however better understanding about risk in emerging markets would benefit from data-based analysis. While investors still see opportunities in OECD countries, emerging markets need to undertake institutional changes to attract more private infrastructure investment. Governments need to work with investors to design contracts suitable for both sides.

Privatisation of brownfield infrastructure has also been discussed. Policy makers should look for opportunities to capitalise on private sector efficiency and select responsible, long-term institutional owners. This process has already made available a significant amount of capital to be reinvested in Greenfield infrastructure, and opportunities remain. While social responsibility is certainly a factor, risk adjusted return remains the driving element for asset managers and their clients. Aligning these two elements is of great interest to institutional investors and could yield significant social benefits.

Several initiatives to collect data on infrastructure investment are under way, both from the public and the private sector. Among the metrics to be collected were cited: the internal rate of return at the project level, return levels of large fund managers, EBITDA, discount rates, yields, information on the investment structure and contract arrangements, indicators on structural characteristics of cash flows, asset pricing structure as well as underlying supply and demand factors. Commitments have been made by large investors to provide private data, given adequate treatment of privacy concerns. The exact understanding of how risks of infrastructure projects differ from risks of other investments will substantially enhance the efficiency of risk allocation in the economy.

The need for dialogue between governments and investors on data collection has been highlighted repeatedly in order to benefit both sides. For the public sector a strong data foundation would allow for more efficient regulation, a crucial factor for long-term investment, while also enabling the optimisation of contract design. In the past, national and international regulators have refrained from adapting certain regulations on infrastructure investments because of a lack of data. On the private side, better data would allow for a more efficient investment process and transparent results in terms of benchmark comparison, whilst investors also stand to benefit from revised regulation regarding asset allocation. Discussions are currently under way to address this issue in the design of new regulatory frameworks for institutional investors.

SESSION IV: The Current Regulatory Environment for Institutional Investors and long-term investment

Panellists first expressed differing views on the definition of "long-term", illustrating the difficulty to set a defined time frame across projects, sectors and business models. While for manufacturing businesses the accounting horizon of a single year makes sense, financial products often have longer time horizons requiring regulatory adjustment. Balance sheet elements like "other comprehensive income" can be useful in this respect, providing smoothing options. Investors are aware that this might also introduce volatility from an accounting perspective.

The effects of regulation on the behaviour of long-term investors are very difficult to quantify or predict. FSB research has not found evidence of a negative impact, but it remains a prominent topic of discussion. Solvency II is still being finalised, which creates uncertainty but also provides opportunities for the private sector to get engaged in a productive way. The capital treatment of an investment depends on the underlying asset. If it is intangible, regulatory cost of capital is generally higher. To better understand the characteristics of infrastructure investments it is necessary to make data available for study, which can provide the basis for differentiated and efficient regulation. Taking into account the business model of various investors is also important.

Using mark-to-market accounting for assets and liabilities is a challenging endeavour – especially for liabilities. The main concern of a company is the result reported on the balance sheet, which might be distorted by mark-to-market valuation of long-term assets or liabilities. The treatment of infrastructure in this context remains an issue. Constructing infrastructure trusts similar to REITs for brownfield assets with contracted revenue was mentioned as a possible alternative: this would provide a securitised structure traded on exchange markets with transparency and disclosure requirements, facilitating exits and capital recycling. Liquidity might be less important to the asset owner if the intended holding period is very long. Discounting future cash flows also introduces uncertainty since the calculated discount rate will be a determining factor.

Speakers have raised credibility issues, given that government has significant influence on national regulatory bodies. Short-term electoral cycles and the resulting potential short time-horizon of selected policies are inconsistent with long-term commitments by investors. Investors are not comfortable with the reliability of single governments. International institutions might be able to provide additional assurances in this respect through principles and guidelines to which governments can commit; however the majority of such measures do not go as far as legally binding measures. Events such as the G20/OECD High-Level Roundtable on Institutional Investors and Long-term Investment have been identified as positive steps in this regard, engaging policy makers and investors. Studying the long-term effects of a breach of contract by the public authority on the terms of subsequent agreements with the public sector might help to understand the costs of such events, however this would require data disclosure.

SESSION V: Investment in Emerging and Low Income Countries

Panellists debated what can be done to attract more private investment in Emerging and Low Income Countries, particularly in infrastructure.

In emerging and developed economies alike the first issue to be addressed, even before regulation, is consensus about involving private capital in infrastructure finance. This question needs to be settled beyond the time horizon of electoral cycles and outcomes are especially volatile in emerging markets and low-income countries. Governments seem to have difficulties convincing the public of the benefits of including the private sector, while also being unable of reaching a stable agreement on the parameters of private participation. This effectively prevents a stable basis for investor confidence in public commitment and for the development of a stable project pipeline.

Relationships have been stressed as particularly important in developing regions. Familiarity with domestic markets and proceedings is a crucial concern for large scale foreign institutional investors, often trying cooperation with local strategic partners to invest directly. Involvement of well-known partners also facilitates public support of the project in the investor's domestic market. The concept of "anchor investor" thus is of particular importance in developing economies.

Projects preparation remains expensive and takes more time in developing economies, increasing the risk of regulatory changes before the project even comes to market. Offering technical assistance and capacity building opportunities to local governments is important. The efforts of MDBs and international organisations in this respect have been welcomed by the panel. Efforts should continue to standardise contracts and educate public and private sector decision makers. Speakers raised concerns that while infrastructure needs in developing countries are growing, the number of bankable projects remains limited.

The increased risk of corruption in emerging economies and low income countries has been recognised by speakers, while not being exclusive to those regions. ESG issues are a rising topic across the globe, but are evaluated with increased scrutiny for projects in emerging economies. Where foreign institutional investors consider participation in a project, they often negotiate ESG matters up-front with the domestic majority shareholder and define binding agreements in contracts. An investor will always compare the situation in a given country to the reality in the domestic market. Governance standards, transparency requirements and due diligence have to be even higher in developing economies in order to attract foreign capital. Governments have made efforts in this respect. Pension funds in OECD countries face increased pressure by the public to emphasise environmental sustainability and governance in their investment decisions: in some instances public opinion can be more limiting than regulation. Projects in developing countries need to meet ESG requirements in order to attract large scale institutional investors.

OECD economies can also foster investment in developing economies by providing a set of good practices and testing new financing instruments. Promoting the use of capital markets to finance infrastructure in developed economies can allow investors to gain valuable experience and familiarise themselves with the asset class, while potentially freeing up bank capital to be invested in other regions. According to some policy makers should encourage projects to get publicly rated after a certain time and promote disclosure of information in order to build a track-record of private engagement. Institutional investors with positive experiences in OECD countries might then be more inclined to invest in emerging and low income countries.

While attracting foreign capital is important for emerging and low income countries, speakers stressed the need to develop local capital markets. Exchange rate volatility remains an important risk in developing economies, thus policy makers should not only rely on foreign capital to finance long-term investment. MDBs and international institutions are working with national governments to deepen local capital markets.

Annex A. Background to the High Level Roundtable

Leaders of G20 countries, at their meeting in St Petersburg in September 2013, endorsing the G20/OECD High-Level Principles on Long-term Investment Financing, asked their Finance Ministers and Central Bank Governors to identify approaches to their implementation working with the OECD and other interested participants by the next Leaders' Summit, in November 2014 in Brisbane, Australia. Follow up work is being carried out by the new G20/OECD Task Force on Institutional Investors and Long-term Financing and will be based on work undertaken for the OECD Long-term Investment project.

The Task Force and the latest research produced by the OECD project on Institutional Investors and Long-term Investment were presented at the G20/OECD High-Level Roundtable on Institutional Investors and Long-term Investment "From problems to solutions: policy measures to address constraints in long-term investment" organised by the OECD together with the G20 Russian Presidency and held on 28 May 2013 at the OECD Conference Centre in Paris.

Building on this first high Level Roundtable, in 2014 the G20 Australian Presidency decided to organise the high-level roundtable with the OECD: "From solutions to actions: implementing measures to encourage institutional long-term investment financing". The meeting was co-hosted by Singapore Ministry of Finance.

In 2015, the G20 Turkish Presidency, the OECD and the Singapore Ministry of Finance organised on the 28th of May the third High Level Roundtable based as last year in Singapore.

The OECD has been making contributions to this global initiative through its project on "Institutional Investors and Long-term Investment", launched in February 2012, building on long-standing work (www.oecd.org/finance/lti). The aim of the project is to promote long-term investment (LTI) such as infrastructure addressing both potential regulatory obstacles and market failures.

Annex B. G20/OECD Singapore High-Level Roundtable on Institutional Investors and Long-term Investment

28 May 2015, Equarius Hotel, Resort World, Singapore

Agenda

8.30-9.10	**Breakfast and registration**
9.10-9.20	**Opening remarks** **Yee Ping Yi**, Deputy Secretary of Finance, Singapore
9.20-10.35	**SESSION I: Role of Capital Markets for long-term Investment. Access to Finance: Financial Instruments for Infrastructure Investment** **Moderator: André Laboul,** Deputy Director, Directorate For Financial and Enterprise Affairs, OECD • **Paulo Correa,** Secretary for Economic Affairs, Minister of Finance, Brazil • **Sara Bonesteel,** Managing Director, Head of Portfolio, Prudential • **Jan Mischke**, Senior Fellow, McKinsey Global Institute • **Matthew Vickerstaff,** Global Head of Structured Finance, Société Générale • **Colin Melvin**, Chief Executive Officer, Hermes EOS
10.35-10.50	**Coffee Break**
10.50-11.55	**SESSION II: Enabling Infrastructure Investment: Addressing the risks** **Moderator: Claus-Michael Happe.** Head of Division, Federal Ministry of Finance, Germany • **Elaine Buckberg,** Deputy Assistant Secretary for Policy Coordination, United States Treasury • **Flavio Romano**, Principal Regulatory Economist, Telstra Corporation Limited • **Cledan Mandri-Perrott,** Head of Infrastructure Finance and PPP, Singapore, The World Bank Group • **Edoardo Reviglio**, Chief Economist, Cassa Depositi e Prestiti, Club of Long-term Investors • **John Holmes**, Senior Vice President, Asia Infrastructure Practice, Marsh (Hong Kong) Limited
11.55-12.15	**Special Session on OECD Business & Finance Outlook** **Adrian Blundell-Wignall,** Director, Directorate for Financial and Enterprise Affairs & Special Advisor on Financial Markets to the Secretary General, OECD
12.15-13.15	**Lunch**
13.15-14.35	**SESSION III: Infrastructure as an Asset Class: Understanding Institutional Investors potential and Bridging the Data Gap** **Moderator: Raffaele Della Croce,** Lead Manager, Long-term Investment Project, OECD • **Frederic Blanc-Brude**, Research Director, EDHEC Risk Institute-Asia • **Julia Prescot**, Partner, Meridiam Infrastructure • **Brett Himbury**, Chief Executive Officer, IFM Investors • **Terry Fanous,** Managing Director, Project and Infrastructure Finance, Moody’s • **Anthony De Francesco**, Executive Director, MSCI

14.35-15.35	**SESSION IV: The Current Regulatory Environment for Institutional Investors and long-term investment** **Moderator: Stephen Lumpkin,** Senior Economist, Financial Affairs Division, OECD • **Richard Thorpe**, Senior Adviser, Accounting and Auditing, FSB • **Leslie Teo,** Chief Economist, GIC • **Tony Cheong**, Group Chief Financial Officer, Great Eastern Holdings Ltd • **Lian Sim Yeo**, Chief Regulatory Officer, Singapore Exchange
15.35-15.55	**Coffee Break**
15.55-17.15	**SESSION V: Investment in Emerging and Low Income Countries** **Moderator: Karim Dahou,** Deputy Head of Division, Investment Division, OECD • **Verena Lim,** Managing Director, Macquarie Infrastructure and Real Assets (MIRA) • **Elisabetta Falcetti**, Director, Infrastructure team, Vice Presidency for Policy, European Bank for Reconstruction and Development • **Edouard Merette**, Managing Director Asia Pacific, Caisse de dépôt et placement du Québec • **Conor McCoole,** Co-Global Head for Project & Export Finance, Standard Chartered • **Ajay Sawhney**, President and Chief Executive Officer, IDFC CAPITAL
17.15-17.30	**Concluding remarks** **André Laboul,** Deputy Director, Directorate For Financial and Enterprise Affairs, OECD **Mehmet Sefa Pamuksuz**, G20 IIWG Turkey Coordinator