FINANCING INVESTMENT FOR THE LONG-TERM: CHALLENGES, PLAYERS, INSTRUMENTS

OECD Financial Roundtable
25 April 2013
OECD Conference Centre, Paris

DISCUSSION NOTE

A. Meeting background and overview

1. The OECD Committee on Financial Markets (CMF) comprises officials from OECD central banks, finance ministries and other financial authorities, who meet biannually to review structural, institutional, regulatory, and market developments in financial services in OECD countries and emerging economies. As part of these meetings, there is a meeting with representatives of the financial services sector – the OECD Financial Roundtable. The Roundtable allows for an off-the-record discussion on a specific topic between Committee members and selected representatives of the financial services sector. This note provides a brief overview and questions to guide the discussion.

2. The aftermath of the current crisis has been characterised by protracted low growth and a low interest rate environment that shows some characteristics of financial repression. As banking sector problems, liquidity and sovereign risks continue to be on policy makers and investors radar, investment opportunities are hard to find and often short-lived. To kick-start growth, risk capital and investment for the long-term is needed, and institutional investors and non-banks are important actors in this endeavour.

3. The fact that "long-term financing for investment, including infrastructure, is a key contributor to economic growth and job creation in all countries" has also been recognised by G20 Finance Ministers and Central Bank Governors at their recent meeting (Moscow, 15-16 February 2013). They have asked the OECD and other international organisations to assess factors affecting, and consider policies to enhance, long-term financing. They also noted that such analysis should take into account the role of institutional investors and the private sector more generally, and was looking forward to an OECD report on "High Level Principles of Long-Term Investment Financing by Institutional Investors". They also encouraged the OECD, together with other relevant international organisations, to provide analysis of different government and market-based instruments and incentives used for stimulating the financing of long-term investment.

4. Against this background, we propose the discussion to take place in two rounds around the following topics:

- Round 1 *(approx. 1h30: 10:00-11:30)*: **Financing investment for the long-term: challenges, (new) players and instruments**:

  (Coffee break, 15 min)

- Round 2 (*approx. 1h15: 11:45-13:00*): **OECD/G20 Draft High-Level Principles of Long-Term Investment Financing by Institutional Investors: Consultation**

5. The questions proposed for discussion as well as the references in the next sections are believed to be germane to these issues but are not exhaustive, and participants are encouraged to raise related points they wish to bring to the attention of the Committee. Participants' interventions should be informal (no slide presentations) and short (around 5 minutes for lead speakers). The meeting is intended to be an open exchange of views between members of the Committee and financial market participants. Committee

Members may use the information gleaned from the discussion to inform subsequent debate or as background information for follow-up work or studies, but specific remarks by participants are not for attribution and participants are encouraged to speak openly.

6. Participants may, should they wish, **provide a limited amount of focused material** to be circulated and made available at the meeting. **Written comments** on the Principles (discussion in Round 2) are also welcome.

B. Round 1: Financing investment for the long-term: challenges, (new) players and instruments

1. Background

7. The current financial market environment in much of the OECD area is characterised by low levels of interest rates and on-going bank balance sheet repair. Against the backdrop of reduced concerns about tail risks following supportive central bank actions, investor risk appetite has remained strong. In fact, there is accumulating evidence that risk-taking in international financial markets is increasing again, with signs of excessive search for yield and overheating in some market segments. At the same time, real investment – and in particular in tangible and intangible assets that expand the productive capacity of an economy – remains anaemic in most mature economies. In part, this situation is explained by the lack of sufficient finance for long-term investments, such as in infrastructure, residential and commercial building, factories and equipment, education and research.

8. **To kick-start growth, risk capital and investment for the long-term is needed, and institutional investors and non-banks are important actors in this endeavour.** Institutional investors such as pension funds, insurers, sovereign wealth funds and mutual funds held well over USD 85 trillion in assets across the world in 2011. Traditionally, these investors – and, in particular, pension funds, life insurers, mutual funds that operate in retirement savings systems, and certain types of sovereign wealth funds – have been seen as sources of long-term capital with investment portfolios built around the two main asset classes (bonds and equities) and an investment horizon tied to the often long-term nature of their liabilities, but these strategies can change. Institutional investors can also play an important role in strengthening domestic capital markets and local currency bond markets, which in turn can increase the scope for some sources of long-term financing.

2. Selected issues for discussion for Round 1

a) How adequate is the **supply of long-term finance** compared to current investment needs at the current juncture? What is the evidence that a **financing gap** left by banks exists and how can the non-bank financial sector fill that gap, at least partly? Is there evidence that this change in roles is already taking place and, if so, in which segments, and who are the (new) players?

b) How do you assess the **outlook for project lending by banks**, especially European ones? What is the current and potential future **role of institutional investors and other non-banks** in funding projects with long-term maturities? In this environment, what is new the role of banks in facilitating institutional investment in infrastructure? How adequate are the **instruments** to facilitate this?

c) Should, and how could, the role of institutional investors in supporting the development of **local currency bond markets** as a source of long-term finance be strengthened?

d) **What can policy do** to facilitate and support the transition towards increased non-bank financing? What role can policy play in supporting financing for long-term investments in particular?

C. Round 2: OECD/G20 High-Level Principles of Long-Term Investment Financing by Institutional Investors: Consultation

1. Background

9. The OECD has developed substantial work on long-term investment, including through its recent project on institutional investors and long-term investment (www.oecd.org/finance/lti). This work has been widely recognised outside the OECD. Acknowledging that *"long-term financing for* investment, *including infrastructure, is a key contributor to economic growth and job creation in all countries"*, G20 Finance Ministers and Central Bank Governors, on the occasion of their 15-16 February 2013 meeting in Moscow, stated that they were looking forward to an OECD report on High-Level Principles on Long-Term Investment Financing by Institutional Investors to be prepared for the G20 Leaders Summit in September 2013 (http://www.g20.org/load/781222043).

10. The **High-level Principles are designed to assist OECD, G20 and any other interested countries to facilitate and promote long-term investment by institutional investors**, particularly among those institutions, such as pension funds, insurers and sovereign wealth funds that typically have long duration liabilities and consequently can consider investments over a long period. The principles complement and do not substitute any existing international principles and/or guidelines. Certain issues covered by the Principles are based on existing OECD recommendations in this area (e.g. Principles of Corporate Governance, Core Principles for Occupational Pension Regulation, Guidelines for Insurers' Governance). These principles are non-binding and high-level, providing general orientation and guidance.

11. A draft of the "High-Level Principles of Long-term Investment Financing by Institutional Investors" will be circulated before the meeting. It should provide guidance regarding policies to support long-term orientation of investments (including investment restrictions and the regulatory, tax and accounting framework), governance of institutional investors, the role of government involvement (*e.g.* private-public-partnerships, guarantee arrangements), disclosure and transparency, as well as issues related to financial education and consumer protection.

2. Selected issues for discussion for Round 2

a) In your view, how adequate is the **balance of the various issues** highlighted in the Principles? What, if any issues, need to be further expanded or added?

b) What are the key **preconditions** for long-term investments? How important are issues such as the development of institutional investors and long-term savings, governance of institutional investors, remuneration and the investment management chain? How important is the role of regulatory, accounting and tax regimes? How do you assess currently the **impact of regulation** on long-term investments by institutional investors?

c) How can the **challenges arising from the relative illiquidity** of long-term investments be best addressed and what are the implications in this context of trends in international investment regulation? What is **the role of information sharing and disclosure in making** long-term investments more liquid?

d) What are the **roles of financial education, awareness and consumer protection**, respectively in the context of long-term investment financing?