TRADE UNION ADVISORY COMMITTEE
TO THE ORGANISATION FOR ECONOMIC
COOPERATION AND DEVELOPMENT
COMMISSION SYNDICALE CONSULTATIVE
AUPRÈS DE L'ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES

High-Level Principles on Long-Term Investment Financing by Institutional Investors

Submission by TUAC

Paris, 19 April 2013

The TUAC welcomes the opportunity to contribute to the work of the Joint Task Force on Institutional Investors and Long-Term Financing, meeting on 22 April 2013 at the OECD Headquarters. In what follows we respond to some of the "selected questions for consultation" that were shared by the OECD Secretariat on 10 April.

Table of contents

Draft Principle 1: Preconditions for long-term investments

Some of the preconditions for long-term investment include a transparent and consistent regulatory, judicial, and tax environment, long term investment policies consistent with prudential considerations, capital market development - including the issuance of long-term instruments by the government –, a favourable business and investment climate, cost benefit analysis and an effective framework for fair competition and corporate governance that protects the rights of shareholders. Do you agree? Are there any other preconditions for long-term investment that should be highlighted in the principles?

Yes there are:
- Defining what long term investment (LTI) is, or what it is not;
- Observing relevant OECD & non-OECD agreements and guidelines; and
- Rule of law.

Defining LTI. The FSB defines LTI as any financial asset which maturity exceeds 5 years and is invested in the productive capacity of the economy (incl. infrastructure, software, R&D, housing, oil, gas and energy). A more qualitative approach should prevail in the HLP based on the OECD definition: "patient, productive and engaged capital"[1]. We would in fact expect the HLP to include a stand-alone principle on the definition of LTI based on the OECD approach, that is:

[1] http://www.oecd.org/insurance/private-pensions/institutionalinvestorsandlong-terminvestment.htm

- "Patient capital allows investors to access illiquidity premia, lowers turnover, encourages less pro-cyclical investment strategies and therefore higher net investment rate of returns and greater financial stability;
- Engaged capital encourages active voting policies, leading to better corporate governance;
- Productive capital provides support for infrastructure development, green growth initiatives, SME finance etc., leading to sustainable growth".

We also believe that the conditions for productive capital "leading to sustainable growth" should be further spelled out to include environmental, social and governance (ESG) criteria in the investment policy of institutional investors and in the reporting framework of asset managers and of invested companies.

Observing relevant OECD & non-OECD agreements and guidelines. We expect the HLP to reference a number of existing internationally recognised standards and guidance instruments which observance by governments and/or by investors would be contribute LTI, including:
- The OECD Principles of Corporate Governance,
- The OECD Core Principles for Occupational Pension Regulation,
- The OECD Guidelines for Multinational Enterprises,
- The OECD Principles for Public Governance of Public-Private Partnerships
- The United Nations Principles for Responsible Investment

Rule of law. A "favourable business and investment climate", the protection of shareholder rights, a judicial system that is "consistent with prudential considerations" and "capital market development" may be needed, but they are not sufficient pre-conditions. There also needs to be effective observance of rule of law. Based on past work conducted by the OECD Public Governance Committee[2] and based the UN definition[3] of rule law, the HLP could reference observance of human rights, including the ILO core labour standards, and the need for efficient and independent judiciary systems that guarantee the rights (including rights to redress and to appeal) of citizens and of all stakeholders (not limited to shareholders' rights).

Beyond public-private partnerships, are there any other major mechanisms for private sector participation in long-term investment projects such as infrastructure that should be mentioned?

Yes there are: 'traditional' public procurement, investment by state-owned enterprises and other forms of public equity. In our view the emphasis on PPPs – as suggested by the question for consultation – is misplaced because PPPs account for a very residual part of public investment in infrastructure[4]. Instead of looking exclusively at PPPs, the HLP should consider a broader spectrum for public and private sector participation.

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[2] GOV/PGC(2011)18) & GOV/PGC(2012)2

[3] "Rule of Law is a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards" http://www.un.org/Docs/sc/sgrep04.html & http://daccessods.un.org/TMP/7118663.7878418.html

[4] PPPs account for less than 15% of total asset value of public sector infrastructure investments in countries that are considers as leaders in promoting PPPs such as South Korea & Australia. PPPs account for less than 5% in Canada, Germany, Italy, South Africa, Norway & Spain. PPPs do not exist in Sweden, Switzerland & Austria Source: "Capital Budgeting and Procurement Practices", 6th Annual Meeting of Senior PPP Officials, Working Party of Senior Budget Officials, 15-16 April 2013 (GOV/PGC/SBO(2013/2)

Draft Principle 2: Development of institutional investors and long-term savings

Policies to promote long-term savings in the population may include financial inclusion, literacy and communication policies, appropriate tax and financial incentives, and mandatory saving and insurance programmes and/or default mechanisms such as automatic enrolment in retirement savings plans. How do you see the relative importance of these different policies? Are there any other policies that should be mentioned in the Principles?

Yes, there are. Financial education, mandatory saving and auto-enrolment in retirement savings plans are important measures that can help raise coverage. But they are not, in our view, primary policy measures that will effectively help mobilise and channel long term savings toward LTI. For example it is clearly not possible for all individual members (regardless of their level of financial education) of a personal pension scheme or insurance product to set their own individual 'LTI strategy'.

The HLP should call for pooled capital through sector-wide collective savings schemes as a central policy measure. Best practice would require such collective saving schemes to be established by social partners. In the case of pension funds, the leaders in investing in LTI infrastructure are all established under sector-wide collective agreements between employers and trade unions, most often as defined benefit or as hybrid schemes.

Draft Principle 3: Governance of institutional investors, remuneration and the investment management chain

Institutional investors need to have the knowledge and risk management capability to manage long-term investments. Do you consider that specific regulations should be applied to these and other aspects of the governance of institutional investors and their asset managers to promote long-term investment?

The HLP should highlight the need for institutional investors to have an LTI investment strategy that articulates the principles of "patient, productive and engaged capital" into operational portfolio terms. Accountability of the governing body to members of the saving schemes should also be highlighted to help establish trust with ultimate owners and prevent conflicts of interest.

A number of specific regulatory requirements or expectations would also apply to asset managers:

- Ensuring reporting to clients put sufficient emphasis on long and medium term financial and ESG risks and returns.
- Exercising and disclosing ownership rights that they hold on behalf of their clients (including shareholder voting rights).
- Strict rules to prevent conflicts of interests, particularly when the asset management entity is owned by a large financial conglomerates that cumulate several banking and/or insurance services, as is the case of global systemically important financial institutions.

Further down the investment chain, it would also be appropriate for issuers (listed or private companies) to observe similar long term reporting requirement and to disclose key ESG performance and impact information, making sure that the right information is available in the markets.

Do you consider that institutional investors should be required to evaluate and manage long-term risks – including environmental risks - that affect their portfolios and to make an informed and effective use of their shareholder rights?

Yes. The investment strategy should include environmental risks, but also social and governance risks. As noted above it should also have a policy for exercising effectively ownership rights (including shareholder rights) that are attached to the assets they hold on behalf of ultimate owners.

Remuneration practices in the fund management industry can be designed so as to promote long-term investment. One way of doing so is to evaluate, report and remunerate the performance of fund managers over a period of years. Do you agree?

Yes. The contract that binds the asset manager to the asset owner, including remuneration and extension of contract clauses, should encourage the asset manager to take a long-term view over portfolio performance. The HLP should also call for full transparency over asset managers' fees and remuneration structures and of other related costs and charges.

Is there a role for government to influence remuneration practices?

There obviously is a role given the regulatory function of government. Self-regulation has failed. But government also has a role via its ownership functions: government should "lead by example" by influencing practices via its public procurement programmes and via state-owned shareholdings.

Regulatory and supervisory authorities overseeing institutional investors can play a major role in monitoring and encouraging long-term investment. Do you consider that the relevant authorities should monitor the governance, agency relationships, and risk management mechanisms underpinning long-term investment and provide suitable guidance to institutional investors? Are there other actions that could be undertaken by the competent authorities?

Yes there are. The 2008 financial crisis has shown the limitation of light monitoring and light supervision. The HLP should support more intrusive supervision and increasing "supervisory intensity".

Draft Principle 4: Prudential regulation, valuation and tax treatment

Do you think that market-consistent (e.g. mark-to-market) valuation standards applied to institutional investors affect their ability to deploy long-term investment strategies? Should any alternatives be considered and if so which?

Mark-to-market accounting rules combined with relatively short-term information from asset managers can make it difficult for institutional investor to focus on LTI, especially when these combine with funding pressure on the liability side of the investor. Potential alternatives to be considered including valuation methods that (i) allow transparent smoothing of liabilities, gains and losses and (ii) that can reflect the underlying performance of assets and investments rather than the market prices on a given day.

What aspects of a supportive tax environment to promote long-term investment by institutional investors would you highlight?

One aspect that could be highlighted in the HLP is the risk for tax bias toward debt financing (through deductibility of debt interest and the use of hybrid structures) which in turn may fuel excessive leveraged investment strategies, as shown by the *boom* in the number of leveraged buyout private equity deals prior to the 2008 crisis.

Draft Principle 5: Financing vehicles and support for long-term investment projects, new ventures and collaborative strategies among institutional investors

Public intervention in long-term investment projects needs to first identify any market failures, carry out appropriate cost-benefit analysis of those projects and ensure that any public support is appropriately priced. Do you agree?

Yes, public support to private finance – as is the case of government guarantees – needs to be priced appropriately. Fair and transparent risk-sharing arrangements should prevail whenever public money is used to support private projects. This is needed to protect public interest (i.e. avoiding "privatising gains and socialising losses") but also to avoid unfair competition in the financial sector, in context of huge market power of global systemically important financial institutions, which was already high prior to the crisis and has increased post-crisis.

Are there any other actions to be undertaken before deciding any form of public intervention with regards to long-term investment projects?

Yes, strict observance of the OECD Principles for Public Governance of Public-Private Partnerships prior to decision to engage public intervention would help alleviate several concerns associated with PPPs regarding risk-sharing, public budget transparency (including contingent liability), contract negotiations, and stakeholder rights.

Draft Principle 7: Information sharing and disclosure

Some of the benefits of information sharing and disclosure on long-term investment include facilitating monitoring by supervisors, enhancing the knowledge of institutional investors, reducing information asymmetries and improving the functioning and liquidity of markets. Are there any other benefits that could be mentioned?

Yes, there is: risk management is enhanced when environmental, social and governance (ESG) reporting is applied throughout the investment chain, from asset owners down to the invested entity.