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

OECD Task Force on Institutional Investors and Long Term Financing

TUAC Submission

Paris, 4 March 2014

1. The TUAC welcomes the opportunity to share comments on the implementation of the G20/OECD High Level Principles on Long-term Investment Financing by Institutional Investors and on the "prioritisation" exercise by the OECD Task Force on Institutional Investors and Long Term Financing ahead of the G20 Summit in Brisbane in November 2014. The OECD Task Force has already identified a number of sections of the Principles for which further guidance would be needed. In what follows we share our comments on these specific sections (Principles 1.1, 1.3, 1.4, 1.5, 1.8, 2.2, 4.1 as well as chapters 3 & 5).

Key messages

2. In general, the need for further guidance should not prevent G20 governments from implementing the Principles without delay, including taking concrete measures to mobilise institutional investors for long-term investment. The Principles should help ensure that institutional investors effectively deliver "patient, productive and engaged capital" but in a responsible way and, at the same time, shift away from short-termist and speculative trading behaviour. As outlined below, our key recommendations regarding specific guidance to the chapters are:

- *Principle 1 (Preconditions for long-term investments).* Job creation is an essential objective for mobilising finance for infrastructure. Guidance on implementation of the Principle should include measures to increase labour market efficiency and job quality in line with G20 commitments made in St Petersburg in September 2013. "Upholding rule of law" should include the effective implementation of the ILO decent work agenda. Regarding project risk management, further work would be needed to address international market bias against risk rating of developing countries and to ensure that publicly financed risk mitigation mechanisms are designed in the way that ensures transparent and fair risk-sharing between government and private sector.

- *Principle 2 (Development of institutional investors and long-term savings).* The leading pension funds in financing infrastructure are all established as part of collective bargaining between trade unions and employers. In order to build large pools of capital, and hence reach economies of scale and increase efficiency, guidance on this principle should address the creation of large sector-wide pension schemes based on negotiations between social partners.

- *Principles 3 (Governance of institutional investors, remuneration and asset management delegation).* Guidance on that Principle should focus on the accountability and transparency of operations by asset managers acting on behalf of asset owners. The implementation of the UN Principles for Responsible Investment

implementation in 2006 can provide valuable guidance for the work on investor risk management – including environmental, social and governance risks. of.

- *Principle 4 (Financial regulation, valuation and tax treatment).* Guidance should among others help address the unintended consequences of mark-to-market accounting rules in valuation of liabilities, gains and losses.

- *Principle 5 (Financing vehicles and support for long-term investment and collaboration among institutional investors).* With respect to publicly financed risk mitigation tools, further guidance should be drawn from the OECD Principles for Public Governance of Public-Private Partnerships which provide a robust set of principles for fair and transparent risk-sharing between public and private investors.

- *Principle 7 (Information sharing and disclosure).* Further guidance should address the institutional investors' reporting framework.

Principle 1: Preconditions for long-term investments.

3. Principle 1.1[1] calls for "framework conditions" to be in place for financing long term investment to achieve a number of broader policy goals, including job creation. Guidance on implementation of that principle should include the commitments made at the G20 meeting in St Petersburg in September 2013[2]: (i) promoting labour market adaptability and efficiency, ensuring adequate labour protection, as well as appropriate tax regimes; (ii) Invest in our people's skills, quality education and life-long learning programs to give them skill portability; (iii) targeted investments to ensure labour market infrastructure and effective labour activation policies; and (iv) improve job quality, including through working conditions, wage bargaining frameworks, national wage-setting systems, and access to social protection.

4. Guidance on Principle 1.5[3] on effective enforcement of the rule of law should cover all stakeholders. As it reads however, Principle 1.5 defines rule of law exclusively for the benefit of investors and creditors. Rule of law, however, should also cover citizens' and workers' rights. Accordingly, further guidance on that principle should cover the effective observance of UN Human Rights norms, standards for efficient and independent judiciary systems and the implementation of the ILO Decent Work agenda, including through adherence to the ILO Decent Work Country Programme[4].

5. Regarding Principle 1.8[5] on government incentives for private sector participation in infrastructure, priority should be given to (i) the design of risk sharing arrangements between

[1] 1.1 Governments should put in place framework conditions that are favourable to long-term investment financing. When evaluating policies to promote long-term investment by institutional investors, policymakers should ensure its consistency with the best interest of members, investors, beneficiaries, policyholders and other relevant stakeholders, and consider its wider potential public impact. In particular, long-term investment can help achieve broader policy goals such as financial stability, debt sustainability, job creation, inclusive growth, higher living standards, competitiveness, sustainable economic development and green growth.

[2] http://en.g20russia.ru/load/782795034

[3] 1.5 A favourable business and investment climate and the consistent and effective enforcement of the rule of law are essential for long-term investment. Governments should create predictable, stable, transparent, fair and reliable business regulation and supervision and administrative and procurement procedures. In particular, policies should consider the long-term financing needs of new firms and small and medium-sized companies. They should also promote an effective framework for fair competition and sound corporate governance, and clear and reliable creditor rights and insolvency regimes

[4] http://www.ilo.org/public/english/bureau/program/dwcp/

[5] 1.8 Where appropriate, governments should provide opportunities for private sector participation in long-term investment projects such as infrastructure and other relevant projects via, for instance, public procurement and

public and private parties and (ii) the market risk "perception" in developing countries. Regarding the latter, there is some evidence of a market bias against risk rating of developing countries, as shown in a report commissioned by the G20 in 2012[6]. With regard to risk sharing, and as discussed below, further guidance on the governance for public risk mitigation tools could be provided based on the OECD Principles for Public Governance of Public-Private Partnerships.

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

6. Regarding Principle 2.2[7] on promoting long-term savings, including "collectively organised long-term savings and retirement plans", guidance should be provided on setting sector-wide pension schemes based on negotiations between social partners – namely trade union and employer groups. Evidence shows that the leaders in financing infrastructure are most often large pension schemes that are based on sector-wide collective agreements – in contrast to company-controlled individual schemes. In the case of clean energy investment, pension funds leaders include Danish Pension Denmark, ATP, US CalPERS & CalSTRS, Dutch ABP and PGGM, Swedish APs and several industry funds in Australia.

Principles 3: Governance of institutional investors, remuneration and asset management delegation.

7. The lengthening of the investment chain between asset owners and invested companies is creating complications in ensuring transparency and accountability in the effective exercise of shareholder rights. Asset managers and other intermediaries in the investment chain ought to be accountable to asset owners and to regulators regarding the effective exercise of shareholder rights. Further guidance would be much welcome regarding Principles 3.3[8] (asset managers' capacity and duty to act in line with asset owners' objectives), 3.5[9] (prevention of conflicts of interest), 3.6[10] (duties to act in the interest of ultimate beneficiaries and owners), and 3.7[11] on asset managers contracts.

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public-private partnerships. Investment opportunities should enable the different parties to earn returns commensurate to the risks they take. Proper planning and effective management of such initiatives is recommended in order to ensure a regular, coherent pipeline of suitable projects. These initiatives should be supported by a transparent, sound and predictable regulatory framework and subject to effective monitoring and accountability. They also require capacity building in government at both the national and local level

[6] Nearly 77% of the 35 Least Income countries (mainly in Africa) and 55% of the 56 Medium Income Countries are still not graded by any rating agency. While 75% of the 52 Upper Income Countries are graded, just 37% are rated "investment graded". Source: "Misperception of Risk and Return in Low Income Countries - Innovative Finance Serving Infrastructure Development: a Win-Win Deal", Roland Berger Strategy Consultants, G20, Los Cabos, June 2012

[7] 2.2 Governments should promote the development of long-term savings through savings mobilisation policies. Such policies may consider the use of default mechanisms such as automatic enrolment as well as, where appropriate, mandatory arrangements. When relevant and subject to the macroeconomic situation, appropriate financial incentives to long-term saving should be provided and tax impediments removed. Governments should also promote the development of long-term savings through pooled investment vehicles and collectively organised long-term savings and retirement plans, increased awareness amongst the population, financial inclusion policies, and the promotion of financial literacy.

[8] 3.3. The governing body of an institutional investor should ensure that the investment management personnel and any external asset managers have the necessary capability to implement the investment strategy and manage those investments in line with the institution's objectives. If outsourcing to external asset managers, the governing body has the duty to ensure that the investment decisions are in line with its objectives.

[9] 3.5 The governing body of an institutional investor should ensure that conflicts of interest that may affect their decisions and those of the persons or entities involved in the management of investments, including any long-term assets, are identified and adequately addressed.

8. Regarding the above, the OECD Secretariat has suggested to develop guidance based on existing OECD guidelines on the governance of insurance companies and pension funds as well as from work developed by the FSB. We agree to this approach but would urge the Task Force to broaden the scope and to include other relevant OECD texts such as the OECD Principles of Corporate Governance which are about to be reviewed by the Committee on corporate governance, as well codes and norms drawn from industry practices. The design of and transparency in regard to the remuneration of asset managers and other mechanisms that encourage long termism should be an important aspect of that work.

9. The Principle 3.4[12] on the need for a comprehensive and robust approach to risk management – including environmental, social and governance risks – could usefully draw specific guidance from the implementation of the UN Principles for Responsible Investment implemented in 2006 – which are referred to in the preamble of the Principles. The Task Force could engage with the UN PRI Secretariat on the practicalities of such work.

Principle 4: Financial regulation, valuation and tax treatment.

10. Regarding Principle 4.1[13] on valuation rules and risk-based capital requirements, we would urge some specific guidance to help address some of the unintended consequences of mark-to-market accounting rules in valuation of liabilities, gains and losses – in opposition to alternative methods that allow "smoothing" of a given period and/or that reflect the underlying performance of assets and investments. Mark-to-market has the merit of "instant transparency". However, it may create volatility in the calculation of liabilities and assets on the balance sheet of investors. When combined with short-termism in asset managers' reporting frameworks, mark-to-market accounting can make it difficult for institutional investor to focus on long term investment.

Principle 5: Financing vehicles and support for long-term investment and collaboration among institutional investors.

11. There are good reasons to support and indeed expand government guarantees and other risk mitigation mechanism to help redirect private financial flows toward long term

[10] 3.6 The governing body of an institutional investor should observe its fiduciary duties towards the ultimate owners or beneficiaries of the assets they oversee. Such duties, when applicable, should include the prudent and efficient management of any long-term assets and the informed and effective use of their investor rights, including shareholder and creditor rights. Those persons and entities involved in the management of the assets of institutional investors should act in consistency with those fiduciary duties or their associated contractual obligations.

[11] 3.7 The governing body of an institutional investor should regularly monitor the performance of both external and internal fund managers. Performance should be evaluated over a period of years, taking into account the institution's investment horizon, its asset-liability management objectives and the level of risk implied. Performance-based elements and contract clauses of fund managers' and senior executives' remuneration should be based on long-term, risk-return criteria."

[12] 3.4 The governing body of an institutional investor should ensure that the institution can properly identify, measure, monitor, and manage the risks associated with long-term assets as well as any long-term risks – including environmental, social and governance risks - that may affect their portfolios.

[13] 4.1 The financial regulatory framework - including valuation rules, any risk-based capital requirements and other prudential measures - for institutional investors should reflect the particular risk characteristics of long-term assets appropriately. The framework should also consider the investment horizon and typical holding period of these investors, while promoting their soundness and solvency as well as broader financial stability and consumer protection. Excessive or mechanistic reliance on external investment or creditworthiness analysis (such as credit rating agency ratings) should be avoided.

investments and infrastructure, as called upon by Principles 5.1[14] and 5.2[15]. However, past experience with the post-2008 bailing out of crisis-hit banks shows that government guarantees can become a very delicate policy issue, especially when they reach up to 20-30% of GDP as they did in the aftermath of the crisis. Public support to private finance does not come for free. It 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. Importantly the need for "leveraging" private finance should not be mixed with, or transformed into unconditional subsidisation of bankers and of asset managers, and/or situations, in which profits and gains are privatised, while deficits and losses are socialised. To achieve this, further guidance should be drawn from the OECD Principles for Public Governance of Public-Private Partnerships, which provide for robust principles for fair and transparent risk-sharing between public and private investors.

12. With regard to Principle 5.4[16] on establishing and promoting pooled vehicles for long-term investment and likewise Principle 2.2, evidence would suggest developing guidance on promoting collectively sector-wide pension schemes and other investment schemes in which governments and social partners have a central role.

Principle 7: Information sharing and disclosure

13. The above discussion on Principles 3.3, 3.5, 3.6 & 3.7 on asset managers' accountability to asset owners and Principle 3.4 on the need for an enhanced approach to risk management could serve as a basis for developing guidance on chapter 7, and in particular Principle 7.3[17] on institutional investors' reporting on the extent to which their investment strategies are in line with their investment horizon.

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[14] 5.1 Public intervention in long-term investment projects - selected in light of socio-economic and environmental impact assessments - should be decided on the basis of identified market failures, should avoid crowding-out private investments, and should be selected by carrying out appropriate cost-benefit analysis of such interventions and ensuring that any public support is appropriately priced and is subject to fiscal considerations.

[15] 5.2 Governments may consider providing risk mitigation to long-term investments projects where it would result in more appropriate allocation of risks and their associated returns. Such risk mitigation mechanisms may include credit and revenue guarantees, first-loss provisions, public subsidies, and the provision of bridge financing via direct loans.

[16] 5.4 In markets with limited participation by institutional investors, governments, national development banks, and multilateral development agencies should consider the need for establishing and promoting pooled vehicles for long-term investment, and supporting other instruments for long-term investment such as project bonds or securitised assets, and risk mitigation policies. Such financing vehicles should have an investment horizon in line with those of the underlying projects and should be developed in close cooperation with institutional investors.

[17] 7.3 Where appropriate, institutional investors should disclose with sufficient granularity information on the extent to which their investment strategies are in line with their investment horizon and how they address long-term risks.