Maximising Finance for Development Flagship

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Speaking Notes

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There is a significant role for global financial institutions (GFIs) to act as a 'clearing house' for infrastructure and climate change investment opportunities – both in developed and emerging markets.

Institutional investors will be needed given the scale of the infrastructure deficit in both emerging countries and for climate change initiatives globally.

Usefully, there is both a strong investor appetite (wall of capital) looking for sound long-term infrastructure investments, including climate change related initiatives. There is no shortage of the supply of capital.

Likewise, there is no shortage of demand for long-term capital for relevant development and climate change projects globally.

The challenge has always been matching this supply of, and demand for, long-term capital.

The barriers to clearing this market are well articulated in the United Nations/World Bank's efforts to improve the flow of capital. Others are also working in this area, including the World Economic Forum (WEF).

To improve the prospects of the 'demand-side' of the equation – people looking to attract long-term capital – some clear steps have been identified by the WEF in its Infrastructure Investment Policy Blueprint.

The **demand-side** steps needed are, in broad terms:

- Clearly identify investment needs (e.g. infrastructure projects);
- Ensure an agreed domestic view on government balance sheet choices (e.g. debt, equity, partnerships) and have a framework established to work within;
- Develop a lasting, transparent, decision making framework for agreeing projects and deciding on partners and risk-sharing;

- Create a long-term pipeline of these projects, providing plenty of lead-up to the tender and design parts of the business, and standardise these across countries to ensure pace;
- Finally, enter the projects in an open fashion, with clarity on the characteristics needed of a successful investor/bidder. It is worth noting that the lowest price tender is often just that for a reason – they may not be the best long-term partner. We need to build capacity within the decision-making authority to assess partners beyond just the price and to include other qualities.

The above points sound simple, but they are almost never found and they are rarely similar across countries. This means there is a real opportunity for GFI initiatives (including Invest4Climate and Maximising Finance for Development) to make a large difference.

On the **supply-side** of capital, institutional investors differ greatly in their purpose, risk appetite, capability, and geographic appetite. As such, it is important to understand clearly the type of investors that are needed to provide long-term capital, and how best to meet their needs and share risk.

The **spectrum of investor-types** span, for example, from passive or active; absolute return or liability driven; short-term stabilisation, strategic development, buffer funds, and intergeneration wealth transfer; and local or global.

Given the heterogeneous nature of these investors, a wide spectrum of investment options need to be made available so that all investors can find their favoured space to 'plug and play'.

At the most generic level, the following features will be seen as necessary **hygiene factors** before capital will freely flow. These features reduce the asymmetry of information between demand and supply, lower the costs to entry, improve the risk-return characteristics for all parties (demand and supply and type of investor), and enable leverage of private sector capital – including partnerships.

Investors of all types would like to see:

- A clear pipeline of opportunities – across countries and investment types (e.g. energy, transport etc). This pipeline and information can greatly improve due diligence costs and provide economies of scale for large investors. For example, several similar projects could be across multiple countries;
- Realistic and welcoming 'risk sharing' in the funding and development of projects;
- Minimum regulatory/legislative/taxation change risk (i.e. minimum renegotiation or country risk);

- Standardised procurement frameworks, both within and between regions; and
- Trusted partners to do business with – preferably GFIs and locals (e.g., local SWFs).

Again, many of these necessary features can be provided/assisted by GFIs such as the World Bank. These are intellectual-capital intensive, rather than financial-capital intensive.

And, the key challenges are 'political' not 'technical', hence the need for GFIs to leverage across countries for standards of behaviour and process to best attract capital.

GFIs must outline how they can best use their 'carrot' and 'stick' options to promote these features.

The challenges outlined are generic to all countries, not just emerging markets or climate related investments. To work properly, the supply-reps and demand-reps need to talk the same language, and the political will must be local to ensure stable and transparent risk-sharing.

Activities that have held up global investment to date are simple:

- Lack of certainty around property rights and regulation;
- Lack of information on opportunities;
- High costs of entry into investments; and
- Limited partnership opportunities between investors, other than passive listed indices.

The efforts being made now by the World Bank must be supported and are well overdue.

The World Bank can be the clearing house for these investments, driving a wider breadth of investment opportunity and type, lower costs to entry, and providing some form of regulatory/country insurance protection against loss of property rights.

Meanwhile, investors must keep progressing recent new initiatives that support the World Bank's goals. These include:

- Ensuring Sovereign Wealth Funds operate in a way that is consistent with the Santiago Principles, providing clarity and confidence as to their investment purposes and capability;
- Creating stronger collaboration and co-investment opportunities between investors and GFIs, and national governments – which is effectively risk sharing;

- Continuing to implement responsible investment standards across activities – increasingly capturing environmental, societal, and governance best-practice standards; and
- Focusing hard on reducing carbon risk, improving carbon pricing, and investing in climate change-related efforts.

The NZ Super Fund's efforts in responsible investment and our climate change investment strategy are all examples of these initiatives in practice – with no detrimental (but in fact positive) impact on our investment opportunities.

These include international collaboration through organisations such as the IFSWF, WEF, Pacific Pension & Investment Institute, Focusing Capital on the Long Term).

The UN, World Bank, World Economic Forum, UNPRI, and IFSWF all need to be congratulated for pushing hard on these hygiene issues, long-term investment practices, and now 'clearing house' roles.

What investors are looking for when infrastructure investing are:

- Stable inflation-linked returns (LDI driven);
- Diversification;
- Upside on capital gains;
- Long-term deployment of significant capital; and
- Appropriate risk-return management.

Sovereign Wealth Funds

Like other institutional investors, sovereign wealth funds are a diverse group. They have different purposes, which will have a big influence on how they choose to invest.

The most appropriate type of SWFs to be involved in EMDE infrastructure projects may be development or strategic funds that invest at home to diversify and develop the domestic economy. Potentially, they have an important role as a trusted local partner to outside investors and crowd-in capital.

More local strategic development SWFs are emerging – specifically tasked to these types of investments and looking to attract partner capital. These include SWFs in Turkey, Ireland, Angola, Russia, Palestine, Italy.

There are challenges for SWFs in emerging markets and developing economies, which can lead them to be cautious.

In infrastructure specifically, those SWFs that do have the capability to invest in assets directly have relatively small teams and large amounts of capital to put to work. Ticket sizes in emerging markets are rarely large enough for them to look at.

Moreover, these types of investments require a very deep and extensive due diligence process and hands-on management, which many SWFs don't have the capacity to take on, particularly in an unfamiliar market.

In terms of financing projects, the capital markets in EMDE countries tend to lack the depth, liquidity and maturity to attract SWFs. A liquid financial market is one of the best guarantors against corruption and other financial risks.

So to attract more SWF capital to major project in EMDE countries, there need to be a larger number of investment platforms, including in the lending and credit space. They would have more comfort that the projects to which their capital is committed are well managed.

There are already institutions that can mitigate the financial risks SWFs might take in investing in EMDE infrastructure. For example, the Multilateral Investment Guarantee Agency would be an important partner in the lending space. In equity investments, involving the expertise of the International Finance Corporation Asset Management Company, for example, would be a valuable addition to the diligence and management of equity investments.

All of these initiatives are important building blocks in the development of a more co-ordinated approach.

Responsible Investment

Another important building block is Responsible Investment.

RI supports long-term returns and is a licence to operate. It must be a key element in investments in emerging markets and developing economies, so that these countries get the benefit of the best standards and approaches, as a launching pad for their future development.

The World Bank/United Nations can act as 'big top' showcasing the various RI initiatives and promoting them in their own investments, as well as in its role as a clearing house.