G20 Study Group on Financing for Investment July 2013

G20 Workplan on Financing for Investment

Study Group's Findings and Ways Forward

I. Executive Summary 3

II. Background and State of Play 5

III. Key conclusions and way forward 7

1. Country-specific factors – the investment climate, key policy settings and institutional frameworks 7
   - Input from country submissions and key conclusions 8
   - Way forward 8
2. Capital Markets 9
   - Input from country submissions and key conclusions 9
   - Way forward 15
3. Private sources of financing/Institutional Investors 16
   - Input from country submissions and key conclusions 16
   - Way forward 23
4. Official sources of financing 23
   - Input from country submissions and key conclusions 24
   - Way forward 30
5. Foreign Direct Investment FDI 31
   - Input from country submissions and key conclusions 31
   - Way forward 34
6. Implications of global financial regulatory reform 34
   - Input provided by International Organisations to date 34
   - Way forward 36

IV. Annexes

I. Executive summary

The Study Group's work has been guided by the five core topics identified as the initial basis for the SG's work:

- **Country-specific factors, identifying those factors that can affect a country's ability to attract long-term financing;**
- **Capital markets, highlighting the role that domestic capital markets, including local currency bond markets, could play in mobilizing resources for long-term financing;**
- **Private sources of financing, including institutional investors, and the extent to which this represented a viable source of long-term financing, including for infrastructure;**
- **Official sources of financing, including multilateral development banks, with particular attention to the critical importance of using the resources and expertise of these entities to more effectively catalyze long-term financing from other sources, particularly in the private sector; and**
- **Global financial regulatory reform and the extent to which it may impact the availability of long-term financing.**

The Study Group has undertaken a country-specific approach in identifying issues relevant to long-term financing for investment, consistent with the Terms of Reference agreed in March. All members have contributed examples and experiences that impact access to and attraction of long-term financing for investment, and the broad range of issues highlighted by member countries show that there is no magic bullet to enhance access to long-term financing. The submissions also showed that the investment climate is a key factor affecting the availability of financing, and improving investment conditions needs to be the first priority.

Reflecting the broad scope of issues identified by members at their face-to-face meeting in Bali in May, the Study Group identified, out of the five preliminary issues mentioned above, three priority work areas that warrant further consideration by the G20. The focus of the Group will be on mobilizing private capital and improving the effectiveness of public investments, including the potential for multilateral development banks to catalyse private finance and their leverage potential in this regard. The priority areas for future work identified by the Group are:

- **supporting improvements in the investment climate;**
- **facilitating greater intermediation of the global savings pool to generate long-term financing for productive investments – be they private or public – of general economic interest in infrastructure and other areas such as SMEs; and**
- **improving the processes and transparency of planning, prioritization and funding of investment projects.**

The international organisations have pledged to contribute a significant amount of inputs, which are aimed at helping the Group to better understand challenges and existing impediments to the availability of long-term financing and to develop potential ways forward. Some of these inputs are available already, and some can be expected in the near future. Input from IOs will be crucial for the Group's conclusions. Also, due to their technical advisory and catalytic potential, IOs can be valuable partners in developing concrete options to improve the availability of long-term funding.

During the work undertaken by the Study Group to date, some areas emerged where other G20 workstreams have already been or are currently active. The Group will build on existing findings to the utmost extent. Any duplication of work is to be avoided.

Further Action

Since the first survey on country-specific factors was very encouraging, the Study Group will undertake further detailed analysis of determining conditions and consider examples of domestic actions being taken to improve the investment climate in relation to long-term financing for investment. This analysis would complement the efforts of the G20 Framework Working Group, where G20 members have committed to a wide range of critical structural reform measures, particularly in areas related to labour and product markets, human capital development, tax reform, and infrastructure.

In addition, the Group could focus on reducing administrative burdens and bureaucracy costs as well as better regulation The Group agreed that another priority area is to examine the challenges associated with channeling the global savings pool into long-term investments. This will require a greater understanding of the respective challenges countries face in deepening domestic capital markets and accessing global capital for investment projects. The Group will consider extending the work already being done under the "Local Currency Bond Initiative" to equity markets.

While the initial work of the Study Group to date has been focused on government policies, going forward the Study Group would benefit from several IO papers on the issues and challenges confronting institutional investors, such as pension funds, insurers and sovereign wealth funds, and their interest in long-term investment projects. With support of MDBs, special attention will be given to the question how to improve PPP projects to create an attractive asset class for i.a. institutional investors. This should go hand-in-hand with greater transparency, reduced complexity and adapted intermediation tools.

II Background and State of Play

At their meeting in Moscow in February 2013, G20 Finance Ministers and Central Bank Governors, recognizing "that long-term financing for investment, including infrastructure, is a key contributor to economic growth and job creation in all countries", welcomed the diagnostic Umbrella Report prepared by international organizations. The Report identified, among other things, that the availability and composition of long-term investment financing had been affected by a combination of factors, some related to the global financial crisis and cyclical weaknesses in parts of the global economy, others related to structural factors and/or longer-term trends.

Recognizing the essential role that long-term financing plays in supporting the goal of strong, sustainable and balanced growth, G20 Finance Ministers and Central Bank Governors agreed to establish a new Study Group on Financing for Investment, which will work closely with the World Bank, OECD, IMF, FSB, UN, UNCTAD and other relevant IOs to further consider issues raised in the diagnostic report and determine a work plan for the G20. The Presidency of the G20 has asked Germany and Indonesia to co-chair the Study Group (SG) which was set up in March 2013. Following consultations with members and relevant IOs, the SG drafted and approved Terms of Reference, and a schedule for its work throughout 2013.

1. Terms of Reference (ToRs)

The Terms of Reference for the SG (Annex 1) were endorsed by members in March 2013 and welcomed by Ministers and Governors in the April G20 Communiqué. The following five core topics were identified as the initial basis for the SG's work:

- **Country-specific factors**, identifying those factors that can affect a country's ability to attract long-term financing;
- **Capital markets**, highlighting the role that domestic capital markets, including local currency bond markets, could play in mobilizing resources for long-term financing;
- **Private sources of financing**, including institutional investors, and the extent to which this represented a viable source of long-term financing, including for infrastructure;
- **Official sources of financing**, including multilateral development banks, with particular attention to the critical importance of using the resources and expertise of these entities to more effectively catalyze long-term financing from other sources, particularly in the private sector; and
- **Global financial regulatory reform** and the extent to which it may impact the availability of long-term financing.

2. Preliminary Study Group Work Program

Building on the five areas identified for further work, SG members in their conference call of March 28th established two separate workstreams, which formed the backbone of the preliminary work program.

a) Country-specific factors

Under the first workstream of **country-specific factors**, SG members, by referring to their experience, decided to share best practises related to long-term financing. Members were asked (i) to outline policy settings, regulations or reforms governments have undertaken and which support a favourable investment climate and/or contribute to greater access/attraction of long-term investment financing and (ii) to identify areas where challenges continue to be faced (see overview in Annex 2).

Study Group Members submitted written contributions in early May.

b) IO contributions

Under the second workstream of **International Organisations**, upon request by SG members, IOs have committed to carrying out a number of initiatives. These initiatives - outlined in greater detail below (and listed in Annex 3) - are of varying degrees of ambition and some elements will require drawing on scarce time and resources.

Some IO-contributions are already available. The main findings of these contributions are described in greater detail in section III.

3. Face-to-face meeting in Indonesia

At its face-to-face meeting in Bali, the Study Group discussed a draft thematic report on countries' submissions and agreed on key preliminary conclusions. These are also outlined later in this report under the relevant headings from the Group's TOR.

Three cross-cutting priority policy issues have emerged. These issues warrant the Study Group's focus and possible action by the G20 in order to support greater private sector participation in investment financing and to improve the efficiency and effectiveness of public investment. These issues are:

- supporting improvements in the **investment climate;**
- facilitating greater **intermediation of the global savings** pool to generate long-term financing for productive investments – be they private or public – of general economic interest in infrastructure and other areas; and
- improving the **processes and transparency of planning, prioritization and funding of investment projects.**

In terms of IO contributions to the work of the Study Group, an update was provided by IOs on work underway including an outline of the relevance of the respective analysis on long-term financing issues and possible policy actions. The Study Group has identified priority topics among the work underway and has encouraged IOs to make special efforts to bring key messages forward where possible. Bilateral consultations might facilitate earlier contributions.

4. Deputies' meeting in June

In June, Deputies received an outline of the work program and an oral report. Discussions among Deputies showed broad support for the approach taken by the Group. Their remarks and comments have been incorporated into this paper to the greatest possible extent. The co-chairs also announced that FDI and the role of equity markets would be added to the work program.

III Key conclusions and way forward

What emerged from the country submissions was the broad scope of issues that countries consider relevant to the topic of attracting and accessing long-term financing for investment. The Group took the view that there is no magic bullet for enhancing access to long-term financing in all circumstances, and the range of relevant issues identified suggests that diverse approaches are needed. This assessment was backed by the Deputies at their St. Petersburg meeting on June 6-7.

Given pressing infrastructure needs in many countries, improving conditions for the financing of infrastructure projects is one area to which the Group will pay particular attention. As it became clear in several workshops, a clear understanding of the definition of "infrastructure" and "long-term investment" would greatly enhance further analysis and potential recommendations. The SG will therefore cooperate closely with IOs and regional development banks, which will be specifically consulted, to develop a common understanding of these terms.

The Group understands its mandate, as outlined in the February communiqué, as being broadly defined to include the long-term financing needs of other sectors which can contribute significantly to growth and employment (e.g., SMEs). To this end, challenges faced in attracting long-term financing by SMEs should also be part of the Group's work, taking into account the work already underway within the G20 in the financial inclusion workstream. Following the Deputies' discussions in St. Petersburg in June, it can be concluded that there is only a marginal overlap with the GPFI workstream, since long-term financing is not an explicit subject for the GPFI. Nevertheless the SG will work in close cooperation with the GPFI to avoid duplication of work. As regards a common definition of SME, the Group will draw on the work already done by the GPFI and the efforts undertaken by the Central Bank of China and the Bundesbank, as described at the St. Petersburg meeting.

1. Country-specific factors – the investment climate, key policy settings and institutional frameworks

The starting point, when considering the country-specific factors affecting long-term financing for investment, is the policy and institutional setting that contributes to the soundness of a country's investment climate. Domestic action to improve the investment climate is a meaningful way for governments to attract global investors to their markets. There are other positive spillovers from implementing policies and reforms to improve the investment climate, such as enhanced productivity, employment opportunities and improved growth prospects.

a) Key conclusions from country submissions

- A sound investment climate is a critical factor affecting the supply of investment financing.
- The existence of a stable and predictable environment in which both domestic and foreign investors can operate is vital for providing investors with the confidence that they require to invest.
- Governments have a central role to play in putting in place policies and institutional frameworks that create conditions conducive to investment. Key conditions countries identified as being important to supporting a sound investment climate include:
  - The need for credible, sustainable macroeconomic policy settings and public finances;
  - Greater certainty and stability to reduce investment risk, driven by factors such as a stable government, adherence to the rule of law and effective institutions;
  - The need for a more stable, efficient and neutral (in terms of reducing the bias towards one financing method over another, such as debt over equity) tax regime;
  - Making ongoing effort to improve the ease of doing business, particularly by reducing administrative burdens and simplifying regulation;
  - Having a sound, stable and well-regulated financial system and access to a significant domestic savings pool;
  - Being open to foreign investment with a transparent and stable foreign investment-regime; and
  - A commitment to improving the investment climate through relevant reforms as the global economy evolves.

b) Input provided by International Organisations to date

- The OECD has drafted the "***High Level Principles of Long-Term Investment Financing by Institutional Investors***", which will be discussed at the July G20 meeting, prior to their submission to the G20 Leaders' Summit in September (for more see page 17). Among other things, these principles (no. 1.4) emphasise that "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."

c) Way forward

While these conclusions from country submissions are preliminary, the issues outlined above represent a powerful starting point for the G20's work on financing for investment. The Study Group will undertake further detailed analysis of these conditions and consider examples of domestic actions being taken to improve the investment climate in relation to long-term financing for investment.

As an immediate plan of action, the Group could focus on reducing administrative burdens and bureaucracy costs as well as better regulation. Since OECD has set up its own workstream in this area, the OECD should be requested to provide the relevant results to the Group.

Any work on improving the investment climate would also have wider implications for supporting growth and would be linked with the broader structural reform agenda. When working on these issues the Group will defer any macroeconomic discussion to the Framework Working Group.

2. Capital Markets

Long-term investment finance is intermediated by the financial system in different ways across the G20 membership. Different financing platforms such as bank financing, local currency bond markets, equity markets and securitization play varying roles across countries.

The importance of capital market intermediation is crucial when considering private sector participation in long-term investment financing. Therefore, supporting the development of capital markets and the investor base and understanding any impediments to intermediation are central points of concern for the Study Group.

a) Key conclusions from country submissions

- The extent of a country's capital market development, including the depth, range and liquidity of financial instruments, the expertise of financial market participants, and the state of financial market regulation and supervision are important factors in accessing the global savings pool for long-term investment and allocating resources to long-term investments.

- Countries have implemented a range of specific policies in areas such as long-term bank lending, lending to SMEs and the development of new capital market segments to provide new borrower groups with access to non-bank sources of finance.

- Based on the experiences of the G20 members, the Study Group concludes that policies to facilitate long-term finance should take a two-pronged approach, looking at both bank lending as well as non-bank capital markets based financial instruments including equity.

- Concerning the development of capital markets, there remains significant scope for better matching potential investors with borrowers, including in the area of SME finance (both for equity and debt instruments), and in providing institutional investors with access to long-term investment opportunities in infrastructure.

- Some Study Group countries outlined the case for:

  - Supporting the development of securitization markets to help unlock additional sources of long-term finance, including important intermediate steps of trading secondary loans, syndicating loans more lending or structuring loans as debt securities that will broaden the appetite for lending in the primary market. Subject to appropriate oversight and data transparency, these can help financial institutions manage risks and free up capital, which can then be mobilised for additional lending.

They should also be based on a high-level of quality and transparency. There is potential to develop prudent, transparent and simple securitization products. Although such standardised products could be supported, inter alia, through partial public guarantees, further discussion may be needed as to the duration of such support: for example, whether credit enhancements should be temporary to kick-start projects and then phased out once investor confidence in the product's properties and a liquid market have been established; whereas permanent risk should be adequately reflected in the risk premium. Dedicated markets especially for SMEs should also be considered. In any case, adequate prudential rules and supervision systems are additional important topics to consider;

- Instruments that involve bundling a portfolio of projects could be considered in various sectors, such as infrastructure. For example, governments could establish and sponsor off balance sheet long-term investment funds (LTIFs), such as the ASEAN Infrastructure Fund or the Indian Infrastructure Fund; alternatively, governments could also establish enhanced regulatory frameworks to support the establishment of LTIFs by the private sector, as is planned in the EU. These funds could help large and mid-sized institutional investors to invest in a range of less-liquid instruments, such as infrastructure projects and other long-term investments, and foster greater diversification. In addition, LTIF managers could bring additional expertise in assessing the underlying transactions, or in selecting and managing long-term infrastructure projects. In this way they would provide institutional investors, such as pension funds and insurers, with expertise not traditionally available in-house.

- An additional challenge especially for MDBs, could be to free up stressed country ceilings by passing country risks to third parties from both the public and private sectors in their search for stable and proven cash-flows.

- More generally, there may be significant scope for promoting infrastructure as an investable asset class, matching the stable, long-term cash flows that can be generated by certain infrastructure projects with the long-term liabilities of institutional investors, such as pension funds, insurance undertakings and sovereign wealth funds (see discussion below). This can take the shape of infrastructure bonds, project bonds (both as an initial investment or as a refinancing tool), infrastructure funds and other similar instruments.

b) Input provided by International Organisations to date

- ***Trends in Domestic Capital Market Development in Emerging Markets and Low-Income Countries*****—IMF (lead) with input from WBG, OECD, FSB**

The IMF note describes the development of various segments of capital markets in emerging markets and developing countries over the past two decades.

Both emerging and developing economies remain largely bank-based. However, many emerging economies have seen considerable growth in capital markets. Capital markets in developing countries remain at a nascent stage of development.

One overarching finding is that, although the capitalization of equity and bond markets has increased significantly on average, there is still considerable concentration, both on the

supply and demand side. While institutional investors are playing a more important role in many countries, they concentrate a significant fraction of their asset holdings in fixed-income instruments, such as government bonds and deposits. The lack of liquidity remains a key concern in many countries.

The Report identifies a sound investment climate as a critical factor for facilitating capital market development, with focus on overcoming market frictions and market failures and with the aim of better functioning markets. Most notably:

- Sound macro policy frameworks - Consolidation of fiscal positions through reforms (reducing fiscal dominance) and the ensuing enhanced policy credibility and reduced uncertainty over investment returns, can play a critical role in increasing both the demand for and supply of financial instruments and services.

- Policies for institutional reform and infrastructure - Interventions that create infrastructures to promote participation can help achieve economies of scale, reduce costs in financial services provision, and facilitate price discovery. At the same time, removal of inefficient regulations, strengthening legal and contractual frameworks, and market-supporting reforms to build up missing market segments can have a positive impact on capital market development.

- Regulation and oversight - A sound regulatory and supervisory system needs to be established with the capacity to address inefficiencies and risks generated by markets and market players.

- ***Implementation Report on Local Currency Bond Markets (LCBM)***

In 2011 the G20 adopted an Action Plan to Support the development of Local Currency Bond Markets. The initial focus of this work was the contribution that LCBMs could make to monetary and financial stability and capital flow management.

International organizations, including the WBG, IMF, ADB, AfDB, IADB, EBRD, OECD, and BIS, with support from the Deutsche Bundesbank, were asked to implement the Action Plan which was composed of three pillars – **improving the coordination of technical assistance** on LCBM development among IOs, **improving data availability** to support LCBMs, and development of a shared **Diagnostic Framework** as a tool for TA providers and emerging market economy policy makers.

An Implementation Report on the Action Plan has been submitted to G20 Finance Ministers and Central Bank Governors for their July 2013 meeting which describes the efforts made as part of the Action Plan. The report is to be accompanied by the finalized Diagnostic Framework, the dissemination of which IOs will be discussing in the period ahead so that it can begin to be used widely as a tool for fostering LCBM development.

The work underway in the G20 Study Group on Long-Term Investment Financing provides an opportunity to focus on the contribution of LCBMs to resource mobilization in support of growth, employment and productivity-enhancing investment. As indicated in the

Umbrella Report local currency government debt markets in EMEs demonstrated resilience in the midst of capital flow volatility and international market instability in the wake of the global financial crisis. At the same time there is tremendous potential for their further development. EME local currency corporate debt, for example, is growing but is still small.

c) Priority inputs to be provided by International Organisations include:

- ***Leveraging Advisory Support and MDB Lending to Foster LCBM Development: The World Bank Group's "Deep Dive" Program*-WBG (lead)**

Strengthen the WBG's contribution to and impact on the development of local currency bond markets by doing "deep dive" engagements in selected countries—which means complementing advisory operations aimed at building local bond markets with targeted IFC investments and transaction support that leverage the advisory work and demonstrate appropriate industry and transaction practices.

The main subjects to be addressed are:

- Providing advisory programs that (1) strengthen enabling environments, including regulatory frameworks, trading, clearing and settlement operations, and capacity of regulators and market participants and (2) support individual transactions, for the purpose of demonstrating obstacles that need to be addressed and best practices of operation.
- Investing in market institutions (exchanges, rating agencies, securities intermediaries, investment funds) to strengthen their capital and provide institution-specific advisory assistance as needed.
- Strengthening issuance through operations such as IFC local currency bond issues, guaranteeing issues of others and investment by providing risk management instruments.

Deep Dive operations will be designed to have a catalytic role in the development of local currency bond markets which are instrumental in providing long-term financing.

Developing LCBMs is a long-term operation. Final results in individual countries typically take 3 to 5 years to materialize and sometimes more. There will be periodical reports on progress, including when new countries are added and others concluded.

- ***Financial Deepening in Emerging Markets: A Comparison with Advanced Economies*— IMF (lead) with input from WBG, FSB, UN-DESA and OECD**

The goal is to assess the current financial sector landscape, identify factors which govern the pace of financial sector deepening and its stability in EMs, and which ultimately account for the differences in market maturity between advanced and emerging market economies.

- Development in domestic and external financial markets of EMs.
- What separates EMs from more mature markets?
- What factors/distortions govern the pace of financial deepening?
- Documentation of EM financial cycles and some analysis of the drivers of cycles.

The project will document the factors which govern the successful transition to mature market status, and the distortions which inhibit or slow the transition. The project will rely on both case studies and analytical work.

The presentation is scheduled to go to the Board in May 2014. A final paper will come sometime after that.

d) In addition the Group will draw on the conclusion of the following paper:

- ***The Contribution of Securitization to the Mobilization of Long-Term Finance—* IMF, WBG and OECD (lead to be identified)**

Securitization can play an important role in financial intermediation. By enabling the mobilization of credit risk, securitization constitutes a potentially valuable tool to assist with the orderly deleveraging and freeing up of bank balance sheets—an issue of particular relevance at the present time for many advanced economies, most notably in Europe. However, problems with securitization were also seen as contributing to the global financial crisis, and this experience has stigmatized virtually the entire industry.

The IMF argues that the broad-based stigmatizing of securitization markets reflects, in part, a misdiagnosis of its role in the crisis; moreover, recent regulatory initiatives could entail significant opportunity costs, at a time when bank funding costs remain elevated and banks have an ongoing need to deleverage. After examining the role of securitization in the crisis within the broader context of a powerful self-reinforcing system of misaligned incentives, IMF suggests securitization was not a principal cause, but rather a channel that amplified some of the underlying excesses in the pre-crisis period. Furthermore, this paper proposes policy recommendations to preserve the beneficial features of securitization, while mitigating its potential harmful aspects (such as complexity and opaqueness). The recommendations are designed to address the factors that contributed to the crisis, or to help alleviate impediments to the healthy functioning of securitization markets. Securitization can at best play an indirect role in addressing issues related to long-term financing. Restarting sound securitization would facilitate bank deleveraging (and reduce their cost of funding). Thus, with banks better able to transfer credit risk as when securitization markets function efficiently, there is relatively more room on bank balance sheets to engage in new lending which would attract further capital charges, such as those pertaining to long-term loans. The project is ongoing and preliminary results will be available end-summer.

e) Equity markets

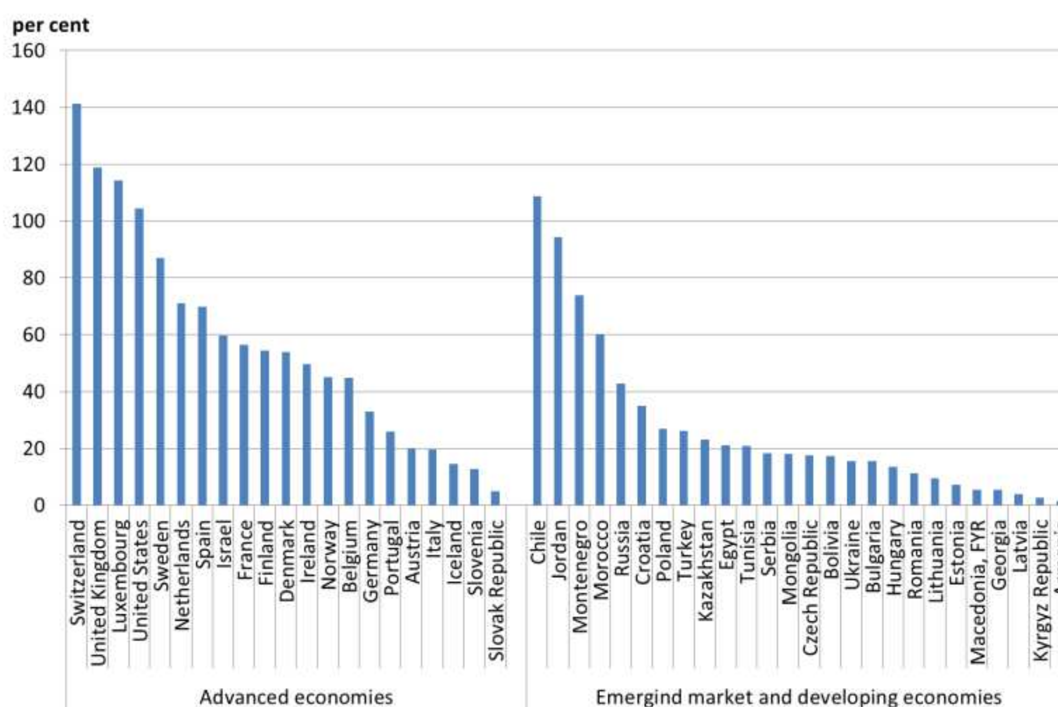
As announced at the Deputies' meeting in June, challenges in further developing equity markets will be covered in greater detail in the Study Group's further work.

Governments' lack of fiscal breathing space, together with deleveraging in the banking sector, have reduced the availability of debt financing. As a result, financing instruments other than debt are being re-assessed. Further developing equity markets is one important option.

Equity buyers typically provide long-term funding and bear business risks. They provide risk buffers for debt holders. Equity financing enables entrepreneurs to embark on new ventures, which can lead to growth and jobs. On the other hand, bearing such risks requires the highest possible governance standards on the side of entrepreneurs.

Market capitalization in many economies is not deep or diversified enough.

Chart 2: Market capitalization of listed companies (% of GDP)



Source: World Bank

Challenges to be faced are:

- Equity markets require a high level of governance standards, which are particularly relevant for foreign investors.
- In some countries, there is a considerable lack of public ownership, which is partly due to relatively low levels of income and savings or an incompletely developed public ownership culture.
- Many countries' equity markets seem to have substantial potential when it comes to improving market capitalisation, turnover and diversification. Market infrastructures seem to be underdeveloped and transaction costs relatively high.

Much progress has been achieved and can continue to be achieved through national activities which aim to further develop the legal and institutional framework for equity markets. However there also seems to be some scope for additional contributions from IFIs.

f) Way forward

In terms of future work, it would be worth considering in greater depth the potential for new instruments/approaches and gaining a better understanding of impacts and stakeholders' perceptions.

The Group agreed that one priority area is to examine the challenges associated with channeling the global savings pool into long-term investments. As mentioned at the Deputies meeting in St. Petersburg, the Group will duly consider national saving rates in this context and draw – wherever possible – on existing work. These issues were only touched upon briefly in country submissions, and the Group's future work and potential recommendations will require a greater understanding of the respective challenges countries face in deepening domestic capital markets and accessing global capital for investment projects.

It is worth noting that there has already been considerable work undertaken by the G20 on Local Currency Bond Markets (LCBMs), which has already been presented to G20 Finance Ministers and Central Bank Governors. The work underway in the G20 Study Group on Long-Term Investment Financing provides an opportunity to focus on the contribution of LCBMs to resource mobilization in support of growth, employment and productivity-enhancing investment.

Equity markets enable entrepreneurs to embark on new ventures, which involve a higher degree of business risk. They can therefore play a key role in creating growth and jobs. Given equity markets' potential for development in the direction of deepening liquidity and

diversification in many countries, it is the Group's goal, together with IOs and with a country specific approach, to work on options to support the development of equity markets.

One option could be to draw on the experiences from the G20 action plan on Local Currency Bond Markets. A key area to be covered could be an analytical input on the state of development and impediments in relation to countries' equity markets (the G20 action plan on Local Currency Bond Markets could perhaps serve as a model). Additionally, measures to align and coordinate technical assistance (e.g. in improving market infrastructure and governance standards or in strengthening the local investor base) could be an important step forward.

Another option could be to explore the role of IFIs. IFIs should be asked about their experience in assisting with the development of the institutional and legal framework for equity markets where needed.

3. Private sources of financing/Institutional Investors

Many of the issues implicit in the topic of private sources of financing are intrinsically linked to the issues outlined above on the investment climate and capital markets. For instance, the size and composition of the private investor capital pool, investors' preferences for different asset classes and the regulatory environment in which investors operate are all particularly important to understanding the scope for and impediments to harnessing private sources of long-term investment financing.

a) Key conclusions from country submissions

See conclusions above under section 1 on investment climate and section 2 on capital markets.

b) Input provided by International Organisations to date

- ***High-Level Principles on Long-Term Investment Financing by Institutional Investors*— OECD (lead), with input from WBG and IMF**

  The OECD set up a Task Force that has, with assistance from the OECD secretariat, developed the High-Level Principles to be submitted to the Leaders´ Summit in September.

  The high-level principles are designed to assist countries to facilitate and promote long-term investment by institutional investors, particularly institutions such as pension funds, insurers and sovereign wealth funds, which typically have long-duration liabilities and consequently can consider investments over a long period, provided these are prudent and capable of producing a reasonable risk-adjusted return. The growth and development of those institutional investors has brought about a transformational change in financial

systems. While they are most present in developed markets, emerging market institutional investors are expected to continue to grow in both scale and influence over the coming decades.

The growth of institutional investors can create the prospect of a larger and more diversified source of long-term financing for physical and intangible investment needs across all sectors of the economy (e.g. infrastructure, company equipment, education and skills, research & development, and new technology). Long-term financing is also essential for the development of small and medium-sized enterprises, especially young, innovative, high-growth firms. Many countries face gaps in relation to the financing of long-term investment in these sectors.

The principles are intended to be consistent with existing regulatory standards for institutional investors, such as those addressing the financial regulation of investments and solvency. When implementing the principles, the specificities of the different categories of institutional investors should be carefully considered. The principles help promote long-term investment by institutional investors and improve the functioning of markets while fulfilling prudential requirements and avoiding potential detrimental impacts on other investments. They are a good basis for governments who themselves are also an important source of investment to create appropriate, consistent policies and establish the framework conditions for long-term investment. The development of the High-Level Principles benefited from the organisation of a G20 Russian Presidency / OECD High-Level Roundtable on Institutional Investors and Long-term Investment on 28 May. The OECD is also expected to carry on further work on effective approaches to the implementation of the High-Level Principles.

c) Priority inputs to be provided by international organizations

- ***Regulations and Incentives Affecting Long-Term Institutional Investors*—OECD (lead), with input from WBG, FSB and UN DESA.**

  The report addresses the impact of different prudential regulations such as governance, investment and solvency on long-term investment by institutional investors. It will also look at other policy drivers of long-term investing such as taxation and institutional factors.

  The report will include a specific practical exercise on the impact of risk-based solvency regulations on investment strategies of pension funds and insurers "funds", based on asset-liability stochastic modeling.

  The report will provide evidence and supporting analysis on the implications of regulations and incentives for long-term investment, covering three main types of institutional investors (pension funds, insurers and sovereign wealth funds).

  The analysis will draw on country experiences and will provide input for the identification of good practices regarding regulation, drawing also on existing international standards including the OECD and IOPS work on pension funds, and OECD and IAIS work on insurers.

Draft of modeling exercise by January 2014. Full draft report by June 2014. Final report by fall 2014.

- ***Insurers and Pension Funds as Long-Term Investors: An Approach to Infrastructure Investment*—OECD (lead) with input from WBG**

  The report will focus on the financial instruments, models, and regulatory and institutional conditions that can make infrastructure investment attractive for pension funds and insurers.

  The paper aims to contribute to the current discussion on the prospects of new infrastructure models and the potential role of institutional investors. The analysis would consider models for infrastructure adopted by selected countries and new models currently in discussion, both on the equity and fixed income side, in OECD and G20 countries. Starting with the analysis of old models still of relevance today (listed funds, private equity and monoline guaranteed project bonds) to new forms (direct/co-investment, club format investment, i.e. pooling of pension funds, new set of infrastructure funds, open-ended model (IFM in Australia, PIP initiative in the UK), EU/UK project bonds initiatives, debt funds and institutional investors' direct lending. The report will address the role of policymakers in promoting financing instruments and models for infrastructure investment by institutional investors that are efficient and sustainable and contribute both to delivering good performance to investors and to a positive economic impact.

  The work would draw on practical experiences by institutional investors around the world, bringing a high level of practical relevance to the work.

  This report will also be an input for the paper requested by the G20 on Analysis of Government and Market-Based Instruments and Incentives to Stimulate Long-Term Investment Finance

  First draft by October 2013. Finalised by early 2014.

- ***Practical Solutions and Models for Addressing Obstacles to Institutional Investment in Infrastructure in Developing Countries*—WBG (lead), with input from OECD**

  The purpose of this study is to examine how institutional investors' capital can be effectively channeled to fund infrastructure in developing economies. The proposed study explores the issue of how to effectively channel these long-term savings into investment in infrastructure by focusing on the role that institutional investors play in developing countries' infrastructure financing dilemma.

  The focus of this report will be on providing examples of how institutional investors have been making infrastructure investments in developing economies. Both successful and less successful examples will be studied in order to develop a set of potential models or tools that other countries can adapt for their own needs. The analysis will focus on how to structure infrastructure financing vehicles in order to make them attractive to institutional

investors – i.e. how to isolate and package different types of risk so that they are borne by the appropriate party.

- *Lack of investor capability – examples of collaborative mechanisms used by institutional investors.* Examples could include the trust structure developed by Peruvian pension funds or how leading international pension funds are becoming open expert sources (GPIF South Africa)
- *Issues with investment conditions – examples of innovative financial instruments and risk sharing arrangements*. Examples could include infrastructure bonds designed for Chilean pension funds, pilot bond project in Colombia, structured products developed for Mexican pension funds (CKDs), Indian North Karnataka Highway deal (bought by Life Insurance Company of India), Indian/Indonesian Infrastructure Guarantee Facility

Based on the case studies, a set of 'models' will be suggested for how institutional investors can be involved in infrastructure financing – for example:

- Bond instruments – including with guarantees from governments/ IFIs/ private sector sources.
- Infrastructure funds - including mechanisms for collective ownership/collaboration.
- Central risk mitigation facility.

Several countries will then be taken as examples (Russia, Brazil, Kenya and Indonesia have been suggested) and their background economic context and level of institutional investor development examined. A mapping exercise will then be carried out with the aim of suggesting which investment model could fit with the individual country context.

The public sector has traditionally been central to the ownership, financing and delivery of infrastructure services in emerging markets, with financing also provided by banks and development agencies. Yet these traditional sources of financing are being squeezed by economic conditions and financial regulation. Policymakers have therefore been looking for potential alternative sources of long-term financing from the private sector. With their growing assets under management and their ability to provide long-term capital in domestic currency, institutional investors have inevitably been the focus of much attention. This paper will suggest practical models for how such domestic long-term financing sources can be tapped in developing economies.

The paper is to be presented to the Group in September.

- ***Investment Objectives and Asset Allocation of Sovereign Wealth Funds*—IMF (lead) with input from WBG and OECD**

SWFs' investment objectives and asset allocations should in theory depend on the individual SWF's specific objectives and financial principles, including risk-return characteristics of alternative investment instruments, and not on other criteria (Santiago Principles). If a SWF aims to avoid Dutch disease effects, it should invest externally.

However, if a SWF's objective is domestic development, then it is expected to invest in domestic bonds, equities, and infrastructure. For EMs and LICs to attract foreign financing from SWFs for development and infrastructure needs, they should first be encouraged to improve their fundamentals and credit ratings; issue bonds in accordance with best practices and international standards; list (infrastructure) equities following international transparency codes; and also maintain their tax/legal/accounting/clearing systems in accordance with international norms.

SWFs with external investment mandates could be a viable long-term source of financing for EMs and LICs' infrastructure needs. Identifying solid EM and LIC bonds and equities for development and infrastructure projects is a major challenge.
SWFs with domestic development objectives directly address the long-term finance of development and infrastructure projects. Prioritization and project selection, especially in the EM and LIC context, are the main challenges.

The note on SWFs' investment objectives and asset allocation decisions will be available in summer 2013.

***Domestic Investment and Sovereign Wealth: The Role of Sovereign funds (Issues Note)* — WBG**

Sovereign Development Funds (SDFs) which have a mandate to achieve a number of domestic development objectives have been established by at least 20 countries. More than half of these are resource exporters, some of which have also established more traditional Sovereign Wealth Funds (SWFs). In some cases the SDF role has emerged out of a broadening of the mandate of a SWF to include domestic investments. The movement towards SDFs as active players in the development strategies of their countries represents a distinct shift in thinking on the appropriate use of fiscal savings arising from natural-resource revenues. In particular, many countries that are either unable or unwilling to tap external investors or donors are looking to use their SDFs to invest in domestic infrastructure.

The purpose of this Note is to consider how countries can maximize the benefits of this shift and minimize the risks. The Note first considers principles that can underpin the relationship between fiscal policy and an SWF, and how the creation of a SDF impacts on these. It then considers alternative institutional arrangements, including (a) the governance structure for an SDF and its relationship with budget institutions, and (b) principles for effective public investment management (PIM). It also outlines arrangements in a number of countries.

Domestic investments by SWFs, including some naturally within the scope of the public sector, which are chosen, planned and executed well, can play an important role in long-term development financing. Experience shows, however, that the downside risk of this domestic investment strategy is considerable. For SWFs to contribute substantially to domestic long-term financing, governance issues, coordination issues related to the budget process, and the relationship to PIM principles all need to be addressed.

A preliminary short Issues Note, which maps the implications of allowing SWFs to invest domestically, is expected to be completed by the end of the FY13 (June 30th). Further work will be contingent on funding being made available, with a full paper expected by the end of 2013, at the latest by the end of February 2014, if there is access to funding from the start of FY14.

- ***What are the Risk-Return Characteristics of Private Infrastructure as an Asset Class?*—** **OECD (lead), with input from WBG**

The general objective of this research proposal is to determine the risk-return characteristics of private infrastructure as an asset class. Initially the focus will be on private infrastructure equity (henceforth 'infrastructure'). At a later stage, risk-return on infrastructure bonds can be considered. The way to achieve this is by estimating systematic risk exposures of the realized cash flows (as well as reported NAVs) of a large sample of infrastructure investments by institutional investors. Scarcity and confidentiality of performance data is a problem for these investments, but by combining anonymous estimates from the various institutional investors with the OECD acting as an independent and objective intermediary, it is possible to compare the outcomes for the different investors and achieve a better understanding of the risk-return properties of infrastructure as an asset class.

The data will be collected from institutional investors, some of whom have already committed themselves to providing such information.

Through this project, the OECD will support stronger efforts in independent data collection and objective information provision in the field of infrastructure investment. While the quantitative and qualitative evidence collected through the survey will be of prime value to the ultimate investors, it will also be used to inform regulators and other policy makers, complementing national and supra-national statistical data collection with a view to better capturing infrastructure flows.

Initial results expected in 2014, but overall project is subject to new funding yet to be secured.

d) Further input from IOs

- ***Policy Guidance for Investment in Clean Energy Infrastructure*—OECD (lead) with input from WBG**

The OECD has applied its experience on strengthening investment regimes to the specific case of clean energy infrastructure. The OECD Policy Guidance for Investment in Clean Energy Infrastructure, to be issued by mid-2013, is a non-prescriptive tool to help governments identify ways to mobilise private investment in clean energy infrastructure through implementing robust policy frameworks for investment. It highlights, in particular, key issues for policy makers' consideration in several areas including investment policy,

investment promotion and facilitation, financial markets, public governance or competition policy.

The policy guidance will be the first such instrument developed by the OECD on clean energy infrastructure investment. It will set out policy recommendations to facilitate such investment across a variety of channels (corporate financing, FDI, institutional investors, etc.).

Draft report on policy guidance issued by end July 2013.

- ***Trends in Global Asset Allocation of Institutional Investors*** **(including from *Survey of Pension Funds' Long-Term Investments*) —OECD (lead), with input from IMF and WBG**

  Assessment of trends in asset allocation by pension funds, life insurers and sovereign wealth funds (main long-term investors), focusing on infrastructure investments.
  The G20 Finance Ministers and Central Bank Governors communiqué from February welcomed the OECD survey on pension funds' long-term investments.

  The report will provide evidence on the extent to which long-term investors are taking up opportunities to invest in infrastructure and green projects.
  The responses will also help inform policymakers regarding the practical challenges faced by institutional investors (in particular pension funds who will reply to the questionnaire) and the needs of such investors to channel their funds to long-term projects.

  Survey on pension funds finalised by October 2013. Full, draft report ready by December 2013. Final report by March 2014.

- ***Institutional Investors and Green Growth: Lessons from Recent Experience*****—OECD (lead) with input from WBG**

  This report analyses case studies on green deals by institutional investors, highlighting lessons for policy makers. It covers sectors such as solar power, offshore wind farms and timber. The case studies involved close interaction with the institutional investors that were involved in the deals in order to obtain a practical understanding of the challenges faced by those investors and the main features of the projects.

  It is the first study of its kind based on case studies that draws on actual experience in various green sectors where institutional investors have been involved. The study provides policy lessons regarding the need for stability in support for green projects and the importance of adequately structuring projects, ensuring that risks are appropriately allocated to those institutions best able to handle them.

  Finalised by October 2013.

e) Way forward

As a preliminary conclusion, the investment climate, intermediation, and greater transparency with respect to major investment projects appear to be key issues that are consistently raised by private investors. While the initial work of the Study Group to date has been focused on government policies, going forward, the Study Group would benefit from several IO papers on the issues and challenges confronting institutional investors, such as pension funds, insurers and sovereign wealth funds, and their interest in long-term investment projects as well as follow-up work by the OECD to the High-Level Principles of Long-Term Investment Financing by Institutional Investors. There should be scope for the Group to open a deeper dialogue with private sector participants to better understand their perspectives and inform the Group's work and discussions. Given the broad range of stakeholders, the institutional framework requires thorough consideration. One option could be to link up with the B20.

4. Official sources of financing

This is a very broad topic as governments and MDBs play a number of key roles relevant to financing long-term investments. These roles include governments and MDBs functioning as financiers of major investment projects, as managers of public balance sheets, and as important players in a country's infrastructure planning process.

Country submissions to the Study Group spanned a range of issues, from using public investment more efficiently, to outlining the different mechanisms used to support greater private sector participation in long-term investments, and the importance of providing greater certainty for investors by developing a prioritized, well planned and well funded infrastructure project pipeline.

Governments also fund the MDBs, which in turn provide a crucial source of official financing for investment and advisory support in many countries. Just as it is important to ensure that governments' resources are used as efficiently and effectively as possible, optimizing MDB's existing resources is crucial. The increasingly important role of NDBs was also considered. Embedded in a domestic legal environment, they could, inter alia, add transparency and facilitate complexities. Nevertheless the Group should constantly bear in mind the principle of public intervention only in the case of market failure, to avoid crowding out private money – where available – through public money. The latter should be used – where necessary – to leverage private money. The rate of leverage by MDBs was mentioned by several Deputies in St. Petersburg as being low. MDB´s were invited by others to explore options on "the scope to more fully leverage existing sources of financing". This rate could be used as an additional performance benchmark for future deliberations.

a) Key conclusions from country submissions

- A key goal must be to ensure that the limited **public funds which are available for investment are used as efficiently and effectively as possible**.
- Countries' experiences seem to reflect sometimes conflicting goals of actively supporting economic development, e.g. by increasing the availability of public long-term-funding, on the one hand, and preserving fiscal sustainability on the other.
- Privatization of government investments with a stable, attractive revenue base can provide investment opportunities for private investors in so-called 'brownfield projects', freeing up government resources to increase investment in new projects. However, experiences with privatisation have been mixed and negative consequences can include poor product or service delivery.
- Greater coordination among different levels of government helps target public investment more efficiently. A number of mechanisms have been used, including a national institution or a high-level committee or commission involving all levels of government involved in funding investment projects, to provide advice on the prioritisation, planning and funding of infrastructure projects.
- Given the expectation of ongoing pressure on government budgets, the official sector can nevertheless play an important catalytic role with respect to the mobilization of private financing, which is the Group's main focus.
- With regard to **direct government measures to support greater private sector participation in long-term investment**, country experiences indicate that governments use various mechanisms to reduce risk and/or make the returns of projects more attractive to the private sector. These interventions are often undertaken where there are perceived market failures.
- The main mechanisms that individual governments have used to facilitate private sector participation in investment projects – besides the involvement of MDBs – include:
  - national development banks and the provision of capital to investment funds, including infrastructure and SME funds;
  - government guarantees;
  - tax incentives and tax concessions; and
  - structuring projects as public private partnerships (PPPs).
- There is a need to continue to learn from country experiences with these government mechanisms to continue to improve their design and implementation in order to make the most effective use of limited government budgetary contributions, and to ensure that government support does not crowd out private sector activity or assume excessive risk.

- There is considerable interest in PPPs across the G20 membership. PPPs can be an effective and cost-efficient way of facilitating public and private sector collaboration for infrastructure provision. However, PPPs can also be difficult to design, require significant expertise and have posed some challenges for a number of G20 members.

- Countries widely recognised the importance of supporting long-term investment financing by **enhancing the evaluation, prioritisation, design, long-term planning and funding arrangements for infrastructure projects**.

- Measures have been suggested to:

    - provide potential investors with greater transparency and certainty about infrastructure projects available for investment, their structure and the level of government funding;

    - lead to the development of better quality project proposals;

    - create an ongoing stream of bankable projects that are of high priority, of national significance and ready for investment; and

    - provide greater clarity about government funding arrangements when multiple levels of government are involved, and of intended pricing regimes.

- Some measures that countries have introduced to achieve this include:

    - introducing national institutions to assist with the development of a long-term infrastructure project pipeline;

    - establishing robust methods of evaluating projects of national significance by undertaking a feasibility study, cost-benefit analysis or assessment against set criteria;

    - developing forward-looking national infrastructure plans; and

    - developing strategies to communicate the public infrastructure projects available for investment to the private sector, including websites, conferences and building relationships between the public and private sector.

- Many of the reforms by countries to evaluate and prioritise projects and/or create national infrastructure plans are relatively recent or are only just being developed. There is considerable scope for learning from country experiences as these reforms are refined and evaluated.

- There is also value in better understanding and assessing investment projects based on their quality (or their impact on metrics such as growth).

b) Priority inputs to be provided by international organizations

- ***Project Selection, Design, and Management as a Catalyst for Financing – by late-2013,* WBG (lead), with input from IMF and OECD**

Matching Instruments to Market Failures in Project Selection, Design, and Management as a Catalyst for Financing, World Bank
The objective is to understand the practical constraints on private financing of infrastructure and the effects of different approaches and instruments aimed at addressing the viability gap. This will be done by assessing the current instruments available to mobilize support or address risk in infrastructure financing (capital transfers, concessionary financing, output-based aid, consumer subsidies as well as credit enhancements, insurance and guarantee products) and mapping them against various market failures to assess which is the most effective instrument under what sort of constraint. Insights about the political, regulatory, institutional and viability constraints on private financing of infrastructure juxtaposed with results of empirical analysis and financial modeling will be corroborated through a "crowdsourcing" exercise, involving a wide range of different stakeholders. This exercise will provide an understanding of the perceived salience of each constraint and show how views might differ among stakeholders (e.g. the perception of governments versus those of private sector financiers).

The analysis will relate observed levels of private investment to the cost of capital and tenors; credit ratings; regulatory viability and financial structuring of projects. Based on the findings of the empirical analysis, a financial modeling approach will be used to estimate the impact of specific risk mitigating and/or government financial support interventions/instruments on the financial viability of projects. The impact of various interventions will be quantified through a common numeraire (e.g. IRR). The modeling will also show the liabilities for each party involved, including the government sponsors, financiers and IFIs, and how these might change with and without the intervention. The results of the financial modeling will be the basis for crafting a package of financial and non-financial instruments that can be tailored to different country contexts as appropriate.

Background Note (based on ground research and preliminary consultations): September 2013, Final Report (based on full demand analysis): June 2014

- ***Optimizing IBRD lending capacity* – WBG - note on its own efforts and perspectives in this area**

Note on (a) parameters determining IBRD's lending capacity, (b) current constraints on lending, and (c) potential for easing constraints.

Given the large unmet demand for long-term finance, it is not just important to explore new financing mechanisms; it is also useful to examine whether existing multilateral institutions such as MDBs are using their capacity in an optimal manner.

Note on optimizing IBRD's lending capacity by December 2013.

- ***Enhancing the catalytic role of MDBs in mobilizing financing,* WBG (IFC)**

  MDBs catalyze additional financing in several ways. The most direct demonstration of the catalytic role involves actively bringing financing partners into deals, in the form of syndications or through co-financing arrangements. MDB resources cannot cover the costs of entire projects, but they often initiate or develop projects in sectors or countries in which private investors would be reticent to invest without some form of official involvement. The paper will attempt to provide aggregated data on resources mobilized by MDBs through these mechanisms. At the same time, there is no intention to update the typology of external development finance beyond traditional ODA or better track the extent to which official development finance can mobilize/catalyze private capital investment for development.

  The focus is proposed to be rather on the innovative approaches and new forms of mobilization beyond traditional syndications such as structures that allow MDBs to purchase equity in firms in strategic or catalytic sectors. The paper will examine the experience of mechanisms developed by some MDBs for making direct equity investments, including through private equity funds (such as the IFC through its Asset Management Corporation). Another aspect of mobilization efforts by MDBs to be covered by the paper is the use of various risk mitigation instruments (guarantees etc.) to crowd in private sector investors.

  Finally, the angle of advisory support for the development of domestic capital markets (including local currency bond markets) in developing countries will be covered as well. Efforts to build and strengthen capital market infrastructure, result in domestic savings being more readily mobilized and made available as long-term financing to support local investment. Direct issuance by MDBs of local currency denominated investment products also play a role in that process.

  Looking forward, MDBs will continue to play a role in assisting countries and firms in mobilizing financing for productive investment. The extent to which they are able to provide direct financing is expected to decline, making it increasingly important that they seek and develop new and better ways to leverage their resources.

  The WBG has begun working on the design of a **new mechanism**. Such a mechanism would create genuine additionality and can serve as an innovative model for resource mobilization and infrastructure financing in an environment of increasingly constrained official sector sources of financing.

- ***Analysis of Government and Market-Based Instruments and Incentives to Stimulate Long-Term Investment Finance – by early-2014, OECD (lead), with input from WBG***

  The final report will provide an international comparative in-depth policy analysis and overview of main types of government and market-based instruments and incentives used to stimulate the financing of long-term investment, based on existing international overviews and new surveys when relevant. The report will also thematically address three main areas of long-term investment financing: infrastructure investment by institutional investors, corporate financing (including issues related to corporate governance) and bank lending (and related business model issues).

  These three specific outputs will be delivered in different parts. The first part, on infrastructure investment, will draw on the report Insurers and Pension Funds as Long-Term Investors: An Approach to Infrastructure Investment (see above). The second part will address issues related to the changing nature of capital markets and their role in financing long-term investment by corporations. It will examine the ability of new firms to come to public equity markets and the explanations for falling IPO numbers and volumes. It will also examine the extent to which companies are issuing bonds to buy back shares and increase dividends as opposed to investing in the business. It will include issues related to corporate governance and the value chain. The third part of the report will address the question of bank models and how leverage, derivatives operations and other aspects of a bank's business may affect its ability to engage in long-term lending.

  Building on the identification of Government and market-based instruments and incentives to stimulate long-term investment finance, the report will provide analysis and policy good practices for addressing related challenges. It will also develop more thematic approaches in three main areas that are critical to long-term investment finance: infrastructure investment by institutional investors, corporate financing and bank lending.

  Section on infrastructure financing: first draft by October 2013, finalized by early 2014. Sections on capital markets and bank business models: first draft by December 2013, finalised by spring/summer 2014. Final integrated report to be provided by fall 2014.

- ***Potential for Pooled Funds as a Source of Infrastructure Financing – by late-2013 WBG (lead), with input from OECD***

  The objective is to understand the current supply of long-term financing being offered by pooled funds and the mechanisms deployed to manage the blending of concessionary financing, private finance and donor aid. Review of the performance of these funds to assess their success in addressing liquidity constraints while assessing the ability of such funds to benefit from economies of scale, longer maturities, access to bond markets and the spreading of risk.
  Regional and global facilities are being designed with the intention of pooling financing from multiple sources to offer investors/contributors wider market access and the opportunity for reduced costs of capital. This review will assess whether such approaches have the potential to extend maturities and introduce new levels of liquidity in the market for long-term finance.

The final deliverable will be a summary sheet of existing and planned facilities that pool financing and an assessment of the volumes of financing, forms of financing, costs and maturities of financing being made available. The results of this work will also be fed into the Development Working Group's outputs for the Infrastructure working stream.

Background Note (based on ground research and preliminary consultations): September 2013, Final Report (based on full demand analysis): June 2014.

c) Further input expected from international organizations

- Success Stories: Country and Sectoral Examples of Overcoming Constraints on the Financing of Infrastructure—WBG (lead), with input from UN-DESA and OECD

The paper will start by briefly reviewing the regulatory, governance and institutional constraints that tend to prevent private investment in infrastructure sectors, and that in turn tend to translate into project level constraints for any given PPP. The major focus will then be on examining in some detail a number of cases, both at country level and specific to individual projects, that illustrate how the above constraints can be overcome successfully. These specific cases are to be analyzed to find out what concrete steps proved to be decisive within the project preparation and implementation framework. The paper will also draw on the lessons learned from IO experiences, including specific investments by IFC as well as from other projects within the UN system. Regarding IFC, the conclusions will be distilled from the data base of its involvement in over 60 PPPs in 35 developing countries, representing approximately $10 billion in investment. These lessons fall into three broad categories: economics, politics, and execution; and they help to understand the fundamental forces that drive the success or failure of PPPs. Finally, the paper will attempt to present a "checklist", simple in form, but rather comprehensive in scope, to help any participant in a PPP process navigate the wealth of critical issues, information, and advice on PPPs.

The deliverable is expected to enhance understanding of problems faced by many countries on the project structuring side of the equation and provide guidance on improving the supply of bankable/investable PPP projects that should tie into the improved access to long-term finance for this type of investment.

Preliminary draft – June 2013, final submission – August 2013.

- ***Subnational Access to Long-Term Financing for Infrastructure*—WBG (lead)**

The report's goal is to understand the market, institutional, and legal and regulatory context within which subnational government entities of developing nations operate, and their access to capital, with a focus on identifying key issues and risks specific to subnational infrastructure lending and investing and on identifying ways to improve efficiency in subnational infrastructure funding and financing.

The report will be comprised of two components. The first will assess the development of the market, institutional, and legal and regulatory framework within which sub-nationals operate, with the objective of identifying key issues and risks related to lending and investing. The second component will focus on factors that impact sub-nationals' access to credit (i.e. the demand side of the equation).

The findings of this analysis will provide the governments of developing countries, multilateral and bilateral organizations as well as other stakeholders with insights on how to support subnational infrastructure development and reduce the cost of capital in this area. The viability of the reforms and solutions proposed will be market-tested, focusing on three main stakeholders: private capital markets, the credit rating agencies and governments, at both the federal and subnational level.

Background Note (based on ground research and preliminary consultations): September 2013, Final Report (based on full demand analysis): June 2014

d) Way forward

The Study Group will prioritize its initial work on the public sector's role in supporting private sector financing of long-term investment by looking in greater detail at the issue of developing a prioritized, well-planned and well-funded (taking into account the work on infrastructure definition) project pipeline and examining how the G20 can take meaningful action in this regard. This work will draw on input from IOs and on deeper analysis of country experiences with planning, pricing, prioritizing and the funding models available for major projects. It would also be possible to work on options to establish standardized, simplified and transparent PPP concepts.

The other key element of this topic is future work on optimizing and leveraging MDB resources. As part of this work, the Study Group agreed to broaden the Group's focus to include key Regional Development Banks.

In terms of working with the Development Working Group (DWG), the Study Group considered that its work is focused on the needs of G 20 countries, including advanced and emerging market countries more generally, while the DWG's infrastructure pillar is focused on the needs of lower-income countries. While the mandates remain distinct, there is clear complementarity in the issues being addressed, which should be maximized and used to rationalize requests for IO work. Officials in member countries engaged in the respective work streams are therefore encouraged to share information on work programs and coordinate individual country positions to the extent possible. Many of the IO staff supporting the two groups are the same, which will help ensure that the lessons learned are consistent and complementary.

5. Foreign Direct Investment (FDI)

The Umbrella Paper presented to Finance Ministers and Central Bank Governors in February describes that Foreign Direct Investment, particularly to emerging and developing countries has recovered significantly after a slow-down as a result of the global financial crisis. At the same time restrictions on Foreign Direct Investment are considered as one factor that "can undermine the incentives for long-term private investment".

In its "Draft Task Force Recommendations on Investments and Infrastructure", the B20 proposed the following measures (among others):

- **Modifications to existing long-term investment regulations and fair value accounting rules**, which affect most long-term investors and financial institutions, in order to address returns volatility driven by short-term market fluctuations. The G20 should invite the "Big 4" (KPMG, E&Y, PWC and Deloitte) to form a panel to analyze existing accounting practices and, in close cooperation with the G20 Study Group on Financing for Investment, to develop a recommendation.
- The creation of a **G20 multilateral investment framework**, setting minimum standards. This framework is expected to significantly increase cross-border investment and foreign ownership of fixed assets, in particular in long-term projects and to increase the stability of the global financial system and predictability of the global investment environment.
- **Improving the mandate and capital base of the World Bank's Multilateral Investment Guarantee Agency (MIGA)** in order to promote Foreign Direct Investment by providing political and credit guarantees for a portfolio of projects in G20 countries. The expanded portfolio and the new financing guarantee model is expected to reduce overall transaction and financing costs and improve bankability.

a) Key conclusions from country submissions

Country submissions already show that a number of countries, given the necessity to involve foreign investors in covering financing needs at longer maturities, have taken action to encourage Foreign Direct Investment, particularly in infrastructure, by various means. Also, a number of aspects relevant for Foreign Direct Investment are already covered by the work on country-specific factors. However, the Study Group will – with significant input from IOs – also take a more focused view on questions specifically relevant for Foreign Investors.

b) Priority inputs to be provided by international organizations

- ***FDI and Transnational Corporation Activities in Infrastructure. The Influence of Industry-, Firm-, and Country-specific factors*—UNCTAD (lead), with input from OECD and WBG**

Foreign direct investment (FDI) in infrastructure occurs when various determining factors exist simultaneously. These determinants are related to the nature of the industry itself, the presence of ownership advantages for transnational corporations (TNCs), specific

locational advantages of the host economies, as well as competitive advantages relative to the home countries of TNCs. Many infrastructure projects can be large-scale and highly risky. FDI involves considerable assets and resources that need to be coordinated and managed across countries. UNCTAD would consider all of these factors and determinants important and identify not only constraints and obstacles, but also favourable factors that contribute to minimizing investment risks and maximizing benefits from FDI in infrastructure. The structure of this study would be: industry-specific factors, firm-related factors, host country factors, home country factors and summary – interplay of various factors.

The goal of the study is to identify and analyze host and home country specific factors as well as firm- and industry-related factors influencing FDI in infrastructure, which can contribute to establishing an efficient and effective institutional and regulatory framework for developing countries that are in need for infrastructure finance through FDI.

Preliminary draft: end June, final draft: end July.

- ***FDI trends in and strategies in infrastructure: TNCs, SWFs, SOEs and Private Equity Funds*—UNCTAD (lead), with input from OECD and WBG.**

  There are a number of different actors pursuing foreign direct investment (FDI) in infrastructure, not only enterprises, including transnational corporations (TNCs) – traditional investors – and state-owned enterprises (SOEs), but also institutional investors such as sovereign wealth funds (SWFs), private equity funds, pension funds and other funds. UNCTAD will discuss trends and strategies in infrastructure investment by these different major players and by different classes of investors together, separately and in a comparative manner, impediments to their investment in infrastructure, and policy options to address the problems and impediments.

  While SWFs and SOEs are state controlled entities rather than private sources, they are included as they are business-oriented and increasingly play a role similar to that of private companies. Nevertheless, from an investment perspective, the distinction between state controlled entities (SWFs, SOEs) and private entities is important, as the former may have criteria other than financial return as their primary motivation for investment.

  The structure of this study would be: evolution of FDI by infrastructure TNCs: trends and patterns, evolution of FDI by SWFs: trends and patterns, evolution of FDI by SOEs: trends and patterns, evolution of FDI by private equity funds (including other funds): trends and patterns, overcoming constraints in infrastructure FDI faced by different investors

  Diversified sources of funds for FDI in infrastructure are welcomed. However, in order to maximize the FDI potential of each type of investor, both host and home countries should try to alleviate the problems and constraints faced by investors. This may unlock the record amounts of cash reserves and investible funds for FDI that TNCs and other investors tend to hold after the crisis.

Preliminary draft: end June, final draft: end July.

- ***Good practices in addressing policy impediments to FDI in infrastructure*—OECD (lead), with input from UNCTAD and WBG**

  The OECD undertakes a great deal of work aimed at helping host countries identify and tackle country-specific obstacles to FDI in infrastructure. Relying on policy instruments such as the OECD Principles for Private Sector Participation in Infrastructure and the OECD Recommendation on Principles for Public Governance of PPPs, as well as on the experience mobilized by networks of PPP practitioners such as the SADC PPP Network or the OECD Network of Senior Budget Officials on PPPs, the OECD is undertaking work aimed at highlighting how to address obstacles to FDI in infrastructure.

  The study will identify policy lessons regarding FDI in infrastructure. FDI is growing in importance as a source of financing for infrastructure, but major policy impediments still exist in some countries.

  A preliminary report reviewing good practices to tackle policy impediments to FDI in infrastructure will be issued by end June 2013.

- ***Improved methodology for measuring FDI, including green FDI*—OECD (lead) with input from UNCTAD and WBG**

  The OECD's Working Group on International Investment Statistics, which sets the world standards for measuring FDI, has started work to develop a methodology to measure green and climate-specific FDI as part of official statistics. This work will be an extension of the OECD Benchmark Definition of Foreign Direct Investment, 4th edition (2008).

  Public finance was the main driver for investment in cleaner and low-carbon infrastructure technologies. However, there is a general recognition that public finance will not be sufficient to overcome environmental challenges, highlighting the need to mobilize private investment, of which the large majority is FDI.

  Many countries are making efforts to put in place policies to stimulate environmentally-friendly investments and to scale up the financing and implementation of green technologies and infrastructure projects. In the absence of adequate statistics, governments face major challenges in assessing the real impact of their policies.

  Short-term results are expected in the course of 2014 and long-term results, presently under review, will require more time.

c) Way forward

The Study Group recognizes how important it is for countries to be as open as possible towards Foreign Direct Investment with appropriate regulation. The Study Group will consider the results of IO work already underway on foreign direct investment, as well as the work of the B20 taskforce on Investments and Infrastructure, before considering whether the Group needs to undertake further analysis on FDI issues.

6. Implications of global financial regulatory reform

Following the global financial crisis, the international financial regulatory reform agenda, championed by the G20, has been aimed at rebuilding stability, resilience and confidence in global financial markets. However, it is important to monitor the impact of these reforms and ensure that they do not have material unintended consequences on the operation of financial markets and supply of private investment.

a) Input provided by International Organizations to date

- ***Workshop on Financial Regulatory Factors that May Impede the Provision of Long-Term Investment Finance (June 2013, Basel)* — FSB**

  To contribute further to the work of the G20 Study Group on Financing for Investment, the FSB held a workshop in Basel on 27 and 28 June to review the impact of financial regulation on the provision of long-term investment finance. This follows up the report prepared and published by the FSB in February 2013.

  There were 3 specific objectives for the workshop:

  - To engage with a wide range of official sector and private sector institutions to assist in identification of specific financial regulatory factors impeding the provision of long-term finance that may warrant a response at the international level, without compromising global financial stability objectives.

  - To identify ways that financial regulation could facilitate the channeling of funds to support long-term investment, while continuing to meet global financial stability goals.

  - To provide feedback on the outcome of the workshop to the FSB and the G20 Study Group on the financing of long-term investment, as input to the FSB's broader framework for monitoring the effects of financial regulation.

  The workshop brought together practitioners in long term finance from the private and official sector to join representatives from the FSB membership of standard setters, national authorities and international financial institutions. Participants came from a wide

range of backgrounds from across the globe, including: finance providers (banks, insurance companies, pension fund and asset managers, infrastructure funds, sovereign wealth funds, and development banks (multilateral, regional and national)); finance users (commercial companies); project finance developers and facilitators (law firms, consulting and accountancy firms, credit rating agencies); and independent experts (academia).

Sessions focussed on: the key features of long-term investment and the influence of financial regulation from the respective perspectives of arrangers and users of long-term finance on the one hand and of the providers of finance on the other; on the impact of financial regulation on hedging long-term risks and use of derivatives; on the effect of current accounting rules on the provision of long term finance; and finally on innovation in the provision of finance and how financial regulation may support innovation and initiatives that could help channel the supply of long–term finance.

The FSB will summarise the workshop discussions and their outcome, and review the implications for the monitoring of the impact of regulatory reform for transmission to the G20 for the September Summit.

b) Priority inputs to be provided by international organizations

- ***Monitoring the impact of financial regulatory reform on the supply of long-term financing*—FSB (lead), with input from IMF, WBG, OECD**

The goals are to assess the impact of specific financial regulatory factors that influence the provision of long-term finance and to continue to monitor whether such factors are giving rise to material unintended consequences that may warrant a policy response at the international level, without compromising global financial stability objectives.

The main findings of such monitoring will be reported to the FSB and to the G20 as part of the FSB's overall monitoring of the implementation of financial regulatory reforms. In order to avoid the duplication of efforts and to ensure continuity, the monitoring will be embedded (where possible) into existing mechanisms and consultation channels established by the FSB to monitor the implementation of agreed financial reforms.

Monitoring of the possible effects of financial reforms on the supply and intermediation of long-term finance will enable any factors that may disproportionately impact the provision of long-term finance to be identified and addressed, without prejudice to agreed financial reforms. Monitoring will also enable financial regulatory factors that may impede the effectiveness and efficiency of financial markets and institutions in the provision of long-term finance to be identified and addressed, without compromising financial stability objectives.

The following steps are being taken/envisaged:

Discuss the possible effects of regulatory reforms on long-term finance in the FSB workshop to share implementation experiences with agreed reforms in emerging market and developing economies (EMDEs)

Identify and discuss financial regulatory factors that may unduly impede the provision of long-term investment finance in a dedicated FSB workshop (see above). Consultation and coordination with FSB members, including relevant SSBs and IFIs, on the findings and next steps in the monitoring process – June/July, review and discussion of draft report by the FSB – August

c) Way forward

To support the analysis being undertaken by the FSB on the impacts of the financial regulatory reform, the FSB held a major seminar at the end of June in Basel. The seminar brought governments and IOs together with private sector participants and standardization bodies to consider a broad range of issues and provide an opportunity for concerns to be aired about the implications of recent financial regulatory reforms, such as Basel III and OTC derivative reforms, for long-term investment finance.

The paper prepared by the FSB will serve as important analytical input and as context for the Study Group's consideration of policy recommendations on the investment climate and capital market intermediation.