ASTRID

Improving the Financing of Sustainable Growth: The Role of D20 Institutions

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President of Cassa depositi prestiti (CDP)

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Ladies and Gentlemen,

First of all, I wish to thank the Australian Presidency of the G20 for endorsing the second edition of the meeting of the D20, the EIB who organized this event and all CDP's professional staff who have worked with the EIB to make this Conference possible.

On July 2013, in Moscow, under the G20 Russian Presidency, for the very first time, a large group of Multilateral Banks and other G20 official financial institutions (which included national Development and Promotional Banks, other G20 financial institutions with a developmental or public mandate as well as the OECD) gathered together in an international Conference on "Sustainable Growth through Long Term Investment". At the end of the Conference they issued a Common Statement to be delivered to the G20 Heads of States. The document, among other issues, underlined the importance of the role of our institutions "*in promoting strong, balanced and sustainable growth at the global level*" and states that "*they believe that active support from G20 official financial institutions is crucially important for those programs and projects, which require long term financing, in sectors such as national and trans-border infrastructure, green, innovative and inclusive growth projects, and projects on mitigation of climate change and its aftereffects, as well as systemic support to SMEs and entrepreneurship*".

Much in this direction has been achieved in the past year. But more should certainly be done in the future. This is the main challenge which we take in this second meeting of the D20, under the auspices of the G20 Australian Presidency.

The aim of the Conference is to investigate our role in the global challenge of achieving green and sustainable growth. We will particularly focus on the importance of attracting private long-term resources to finance infrastructure and SMEs and to use the scarce public resources in the most effective way. We will also emphasize the synergies that could result from closer cooperation between the D20s, the MDBs , the NDBs in their common efforts to support growth and employment.

The D20 is a group of diverse and different financial institutions. They share a common mission to support specific public policy objectives of their respective shareholders.

The long-term investment issue has now become absolutely crucial. In fact, the economic recovery still facing, at least in some countries, the threat of a triple-dip recession requires strong investment in the real economy, such as infrastructure, innovation, research & development and SMEs. Such investments are also essential to guarantee the sustainability of the public finances consolidation plans, which cannot be achieved over time without a reasonable level of economic growth (and inflation).

In this context, there is great momentum and growing role of Development and Promotional Banks around the world. According to a recent research, there are 286 Development Banks in 117 countries at the present. Most of them are listed in stock markets and are acting as private sector financial institutions pursuing, at the same time, public and corporate financial interests, goals and objectives.

The conclusion of the 'umbrella paper' prepared by the World Bank staff for the 2013 meeting are still valid. In the last sixteen months, several countries have started the work foreseen in the 'umbrella paper', with the technical support of Multilateral Development Banks and of their own National Development and Promotional Banks.

In Europe, from the outset of the crisis, in 2008-09, the LTIC brought the issue of the crucial importance of long-term investment for the economy at the attention of the EU and of the global community. Today increasing LTIs for infrastructure and SMEs is at the center of the agenda of the next EU legislature. Last year, for the very first time, the G20 under the Russian Presidency, included the issue in its global policy agenda. We certainly welcome this process. Although we still believe that much more should be done. After four years of words (and some deeds), it is high time to move on to deeds. I trust that the D20 group shares this view strongly.

Ladies and gentlemen,

Global financial markets are undergoing a great transformation. Financial institutions, capital markets and institutional investors play a crucial role in providing

and channeling financing for businesses' day-to-day operations and for long-term finance as key driver of growth, competitiveness and employment.

Commercial Banks have been a key player in the financial system. Over time, the traditional banking model has evolved, shifting from an "originate and hold" to an "originate and distribute" approach, which, interacting with a weak regulation, created excess leverage and greater interconnectedness risk through counterparty exposure. The asset quality reviews (AQR) and their stress tests should speed up the restructuring of the bank balance sheets. The European banking union with its related mechanisms are an important step in providing the economy with a banking system which can finance it.

The ambitious financial system reform programme has the dual objective of: (i) making the institutions more robust and less vulnerable to any financial market shocks (ii) breaking the risk transmission a vicious circle between bank assets and sovereign securities in both directions, from bank assets to sovereign securities and vice versa from sovereign securities to the banks.

The emerging long-term financing gap is particularly acute in the infrastructure sector, but Development and Promotional Banks, as institutional investors, are in a position, at least partially, to fill in that gap. They have the credibility to act as intermediaries of financial flows for a number of reasons: long history (track record); reliability (non-volatile behavior); political institutional weight; in-depth local knowledge; benefit from preferred creditor status; strong balance sheet and financial strength; delivered returns consistent with risk (and market); habit to support long-term investment also because of their public mission.

Development and Promotional Banks have the main goal is providing medium and long-term capital for productive investment, often accompanied by technical assistance. These productive investments should be identified, appraised and selected with a two-fold set of criteria: in the short term, they should help make full utilization of production factors while, in the medium and long-term, they will provide physical, financial and technical capital. They have a key role in implementing both private and public investment projects able to maximize not only private but also social returns.

In 2005, the UN defined these type of institutions as *"Government owned financial institutions with the objective of fostering economic or social development by financing activities with high social returns".* According to UN, since Development Banks target well identified market failure, their lending does not cause any crowding-out effects of the private sector. To ensure the previous objectives, they need adequate governance with a financially sustainable business model.

New instruments and new agencies (MDBs and NDBs) are therefore going to be needed to mitigate risk and face credit crunch. They should work as catalyzer of institutional investors' participation to infrastructure and SMEs financing, by playing credit enhancement and leave to institutional investors the senior part of debt and by attracting co-investments in the equity side of the projects. They may also have a subsidiary role to support commercial banking, which may receive cost-covering margin for on-lending promotional loans. In doing so, they become complementary to the market and, at the same time, the privileges of Development/Promotional Banks (tax exemption, public guarantee) do not distort competition because they fill market failures and may have a role in balancing economic cycles. Among the new instrument which may need to be reinforced by Governments' agencies, Multilateral Development Banks (MDBs) and National Development Banks (NDBs), there are credit enhancement mechanisms, such as monoline mitigation mechanisms, which may include credit guarantees, first-loss provisions, and the provision of bridge financing via direct loans.

Finally, the recourse to PPPs can often be an alternative way to both direct Government and corporate infrastructure initiatives. The scheme should, therefore, be promoted, particularly in a fiscally constrained environment. The D20 institutions can continue to provide important expertise to enhance this model.

In Europe, in particular, while waiting for a return of stability in the banking system, the role of large national and multilateral development and promotional banks (EIB, KfW, CDC, CDP, ICO, BGK, PKO, and some others) has become increasingly important. New financial instruments have been designed; additional resources have been mobilized to support the economy during the crisis, most importantly by financing infrastructure and SMEs, either directly or through the banking system; and new European and domestic long-term equity funds have been launched to invest in infrastructure projects and strengthen company capitalization. Cooperation between these institutions could lead to further new initiatives and new instruments. On the debt side, for instance, the EIB Project Bond Initiative (PBI) goes in this direction; while, on the equity side, long-term infrastructure funds such as the Marguerite Greenfield LT Fund could be used as "prototypes" for broad "families" of long-term funds for investment in infrastructure, technology, R&D, SMEs, start-ups, local utilities, energy, urban development, health care, compensating for the general shortage of risk capital engendered by the crisis.

More has to be done to create e more friendly regulation for long-term investments.

Firstly, currently, the main accounting rules and supervisory requirements (Basel III-CRD IV, Solvency II, the IORP, IFSR) still tend to favor short-term and penalize long-term investment. CRDIV has passed to vote of the European Parliament. Realistically, recalibration could be contemplated later in time (especially in terms of the ratio of liquidity and capital absorption for certain asset classes). There is still a

space, even if small, on Solvency II, to obtain a more favorable treatment to long-term investment. Pension funds will, it is hoped, capitalize on the work done by insurance to obtain some significant changes. Generally, if there is a strong interest from the market and a strong support by the Governments to create a new "asset class" represented by the infrastructure and, more generally, by the long-term investment, it will mean that some major changes are inevitable. Regarding IAS in relation to the business model the road seems to be still rather "uphill".

However, on 2 May 2011 at a conference in Paris organized by the ECB and the EIB, we as leaders of the founding members of the LTIC held a meeting with Mr. Mario Draghi, Chairman of the Financial Stability Board (FSB), during which we raised the subject of the relationship between the business model of the various long term institutions and the mark-to-market philosophy which is the foundation of the International Accounting Standards (IAS). Mr. Draghi immediately grasped the point and assured us that he, in turn, would have brought the matter to the attention of the FSB. A few years later, upon the order of the G20, the FSB produced a report on the topic of the LTI in which the question that we then had raised with Mr. Draghi was discussed for the first time. The subject is of course still open. A special LTIC Working Group is talking with the FSB. The question is whether it is appropriate to introduce an additional category for financial assets which do not fall within the definition of amortized cost or in that of fair value through the category of the profit and loss account for financial assets which are on the books in the medium and long term. The hope is that this dialogue will provide solutions which do not penalize those institutions which have a business model based on long-term assets and liabilities (such as pension funds, insurance companies and Sovereign Wealth Funds, SWFs) or which operate on a long-term and the public interest mission (such as national and multi-lateral development banks). After all, the concept of "value in use" is already defined in IAS 36 - Paragraph 6: "Value in use is the present value expected from an asset." This definition could be extended to financial assets held by institutions which intend to keep them in the portfolio for a long period of time. It would prevent the main profitability indicator of an asset from being distorted by short-term fluctuations. The experts, however, are well aware that, although logical, such an address would find technical and ideological barriers difficult to overcome.

Secondly, tax systems, which have a direct effect on investment decisions and on savings. More generally, taxes may be used to correct externalities that come from market failures. This is the case for project finance for infrastructure. Corporate taxes in most countries tend to favor debt to risk capital, thus creating generally higher incentive leverage relationships. Interest rates are, in fact, deductible, while returns from capital are not. Financial deleveraging should be an important goal of economic policy. Savings taxation can change behavior, allocation of capital and investment. Many States have introduced incentives to increase (long-term), savings as occurs, for example, on retirement savings. Finally, tax incentives may encourage PPP. There

are strong reasons in favor of such incentives. On the one hand, in fact, they make it possible to make investment which would not otherwise have been made because they needed public resources; on the other hand these investment contribute positively to growth and thus to fiscal consolidation.

This is an incontrovertible fact, at least in all those cases in which the incentive is strictly directed to re-balance the financial plan of work which had suffered an adverse effect from the cancellation of subsidies or an increase in the cost of bank loans. It must be limited to that higher portion of taxes collected, generated from investment, net of substitution factors.

It should not be forgotten, finally, that we must avoid the tax incentive contributing to distort the risk assessment leaving space to “moral hazard”

Thirdly, at European and national level, much remains to be done to have an investment friendly regulation, and to reduce risks and regulatory costs. Political and legislative stability, streamlined and fast administrative procedures, regulatory and bureaucratic burdens contained, a fast and reliable judicial system, an efficient and technically prepared public administration are known to be decisive factors in investment decisions, which today have the entire globe as their horizon. Despite some recent progress, in many European countries, the quality of regulation and regulatory risks remains one of the major obstacles to the LTIs. In the European administrative space it is now possible to envisage a European better regulation policy, looking to ensure the convergence of European and national regulations towards investment-friendly models.

Ladies and gentlemen, let me conclude by summarizing some of the key points which characterize our present and future role in the global economy.

First, the D20 reaffirm its commitment to support the development and financing of infrastructure projects and facilitating the financing of SMEs, by increasing their cooperation, especially between and among National Development and Promotional and Multilateral Development Banks. Providing policy advice, sharing knowledge and promoting capacity building are the main goals of the D20.

Second, D20s are in the position to contribute to set standards and provide leadership working in close cooperation with Member States and Unions of States.

Third, the D20 bring substantial lending capacity, linkages to the financial sector and capital markets and experience and knowledge about local institutional and regulatory conditions.

Fourth, the future global demand for long term investments is going to be so huge that we can give a real contribution only if we succeed in attracting the private sector and manage to harness the power of capital markets. The objective should be to develop infrastructure investment into an “asset class” with distinct regulation, in order to allow both domestic and international institutional investors to allocate to it a

larger share of their portfolios.

Finally, the recourse to PPPs can often be an alternative way, to both direct Government and corporate infrastructure initiatives. The scheme should, therefore, be promoted, particularly in a fiscally constrained environment. The D20 banks, which have developed, across many years, high skills in PPP, can contniue to provide important insight and expertise to enhance this model.

Working closely with the G20 as a group would ensure that policies decided at G20 level can be implemented at best.

The D20 goal, in cooperation with MDBs, is to move beyond traditional long-term lending and play a catalytic role for commercial financing on a larger scale and thus provide a necessary bridge between governments, projects sponsors and capital markets.

Thanks