PROMOTING LONG-TERM SAVINGS VEHICLES AND INSTRUMENTS

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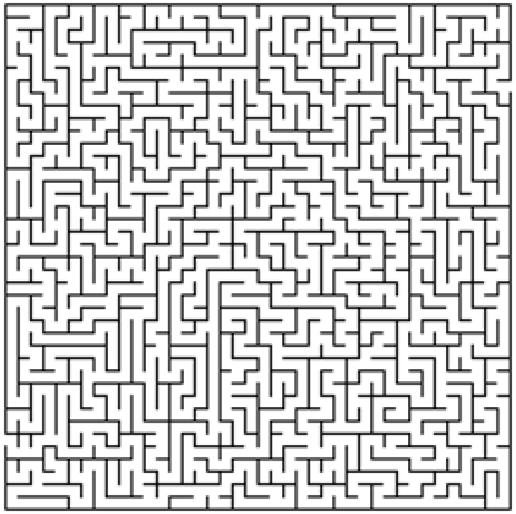
OECD
BETTER POLICIES FOR BETTER LIVES

Navigating a path through the presentation



Why long-term savings?

A large body of evidence confirms the importance of efficient investment for economic growth and sustainable development.

- helps to expand an economy's productive capacity, drives job creation, supports income growth and reduces inequality
- can also help to improve the efficiency of existing assets and improve living conditions of the population.

scale of the long-term investment requirements and the constraints on many government budgets => governments will likely have to partner with the private sector to meet at least some of these needs.

- Need for alternative sources of financing for long-term investment projects
- motivated in some cases by constraints on traditional sources of financing such as bank credit.
- institutional investors and capital markets more generally are frequently mentioned in this context

A necessary requirement for long-term investments on the part of institutional investors is a pool of long-term savings

Weren't we talking about savings? Why the reference to investments?

Savings <u>and</u> investments by individuals are important not only for their own personal financial well-being but also for economic growth.

- There are various ways in which individuals save: holding surplus income as cash (e.g. in mattresses), via simple informal saving mechanisms such as savings and loan clubs, in complex financial vehicles, or non-financial saving such as property.
- Some of these approaches are more suited to short-term savings and income smoothing, whilst others provide long-term savings to draw on in future periods

So, there are two basic financial issues that need to be addressed:

- The funding decision -- how much to <u>save</u> to provide future income?
- The investment decision -- how to <u>invest</u> the funds that are set aside?

Saving enough for a long-enough period of time

The objective: encourage individuals to save more, or to save more appropriately (invest).

The evidence: some individuals save adequately…

and some others perhaps save more than is strictly necessary…

but many others are not making adequate provision for their financial futures in general and for their retirement years in particular

What to do about it? Financial framework conditions

Various transactions and information infrastructure are needed to support financial activities and the entire process is influenced by the legal and regulatory system, supervision, tax laws, societal and industry norms and other environmental factors.

Relevant factors exist in 1) the macroeconomic environment, 2) the financial environment, 3) the entrepreneurial and broader business environment, and 4) at the level of individual investors and investment projects – the microeconomic environment.

Sound fiscal, macroeconomic, and monetary policies not only help to support a sustainable level of aggregate economic activity and to contain major internal and external balances, but also provide the economic backdrop needed to enable financial institutions to be profitable without taking on excessive risks, necessary conditions for the development of the financial sector and capital markets

Hence, before considering measures to expand particular alternative financing mechanisms, it is necessary to ensure that the basic legal and regulatory infrastructure for long-term investment is in place.

A few core issues for investors

Investment may be held back in structural terms by inability or unwillingness on the part of investors to undertake real investment.

Investors are willing to commit their funds to investments only when they have some assurance that financial markets and institutions are safe and sound, and operate according to rules and procedures that are fair, transparent, and free from conflicts of interest and other agency problems.

Investment integrity requires proper and transparent choice, but within the limits of the diversification paradigm and with adequate regulation, disclosure, accountability and better financial education and training to facilitate proper risk assessment

More on the financial education/inclusion front

Some segments of the population may encounter barriers to saving, which can include limited access to financial markets, lack of familiarity with complex financial products, and in some cases, limited knowledge and understanding of basic saving and investment concepts.

In addition, there can be behavioural and cultural factors which may limit individuals' propensity to save.

Higher levels of financial knowledge and skills are associated with increased long-term savings and improved investment behaviour

=> Reforming the education system, including research, as well as investing in human capital in an ambitious, stable and consistent way is seen as key to raising the long-term potential of the economy

Mobilising savings

Measures commonly adopted to influence whether and how individuals save:

- involve a combination of prudential regulation of service providers and
- consumer protection rules,
- financial and tax incentives, and
- financial education and awareness initiatives.
- The latter measures include efforts to improve basic education levels, enhance labour force skills, and support financial inclusion

Mobilising savings via financial education initiatives

Well-designed initiatives can - and do - stimulate long-term savings and investments. Effective financial education initiatives for long-term savings and investments include (but may not be limited to) those that are:

- **Of sufficient duration and frequency**: there is some evidence that longer financial education programmes have stronger effects, but that there is a point at which there are no further gains from increasing the amount of education provided.
- **Provided at work**: Workplace education designed to increase retirement savings has been shown to lead to increased enrolment and/or contribution into pension schemes, both amongst participants and their co-workers (and particular among those with lower levels of saving).
- **Delivered alongside opportunities and incentives to save**: Financial education seminars combining presentations and case studies on a range of financial literacy topics have been found to increase savings into Individual Development Accounts.
- **Strategically timed**: several effective interventions have been timed to coincide with particular teachable moments, such as during a period of open enrolment for pension funds or as a worker plans to migrate.
- **Technology-based**: Technology and media have been successfully employed to make financial education more engaging, and to help improve long-term savings and investment behaviour.

Reasons to promote institutional investors

- To provide increased retirement income for an ageing population, thereby relieving pressures on budgets associated with state-financed pay-as-you-go systems;
- To promote the development of an equity culture
- To make risk capital available to new or innovative enterprises
- To increase the range of choices available to investors and firms
- To develop more efficient financial intermediation and more effective systems of corporate governance

Definition of institutional investors

Institutional investors:

- entities that invest savings of individuals and in some cases non-financial corporations in financial markets
- sector basically comprises the non-depository financial institutions, sometimes referred to as the financial "contractual and investment" institutions
- Also includes sovereign wealth funds, SOEs, public pension reserve funds
- key characteristic is that funds are being managed <u>professionally</u> or <u>institutionally</u>,

Common Characteristics of Institutional Investors

Long-term savings vehicles

- Managed professionally
- Special Regulatory Regime

Fiduciary duty to investors supported by

- Law and regulation
- Market competition

Other features

- Differing liability for future payments
- Tax status
- Execution of investment strategy

Mapping infrastructure investment channels

Asset Category	Instrument	Capital Pool	Corporate Balance Sheet / Other Entities	Infrastructure Project
Debt	Bonds	Bond Funds, Bond Indices	Corporate Bonds, Green Bonds	Project Bonds
				Municipal Bonds/Revenue Bonds
			Subordinated Bonds	Green Bonds/Sukuk
	Loans	Debt Funds	Direct/Co-investment lending to infrastructure corporate	Direct/Co- Investment lending to Infrastructure project / project loans
		Securitised Loans, Syndicated Loans, CLOs	Syndicated Loans	
Mixed	Hybrid	Mezzanine debt funds	Subordinated Bonds, Convertible Bonds	Subordinated Loans, Mezzanine Finance
Equity	Listed	Listed infrastructure equity funds, Indices, trusts	Listed infrastructure & utilities stocks	YieldCos, Closed-end Funds
			MLPs, REITs, IITs	
	Unlisted	Unlisted infrastructure funds	Direct/Co-investment in infrastructure corporate equity	Direct/Co-investment in infrastructure project equity

Source OECD

Considerations on investment regulations and investment strategies

Value of quantitative investment regulation vs. alternative risk return policies of pension funds

- Simple quantitative limits have some advantage over risk-based regulation, and could achieve the same results as more complicated regulatory approaches (e.g., minimum returns with a certain security level), but only in the case that the model is validated by real events
- Long contribution/accumulation periods may allow for a larger share of riskier assets/higher replacement rates but also higher risk of shortfall

Policies impacting the long-term investment of insurers

- Risk-based capital requirements can account for the interaction between assets and liabilities and thus encourage investment in assets with a duration in line with the liabilities
- Other government policies may also influence investment

THANK YOU!

Did you find your way through the matrix?