INVESTING IN INFRASTRUCTURE: BUILDING EXPOSURE TO THE ASSET CLASS

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The OECD is supporting the G20/APEC agenda on long-term investment through the G20/OECD Taskforce on Institutional Investors and Long Term Investment Financing (G20/OECD Taskforce)

See [www.oecd.org/finance/lti](http://www.oecd.org/finance/lti)

Towards a **holistic approach to long-term investment analysis** addressing private sector participants across the value chain (corporations, banks, institutional investors), including a broader range of issues (investment and financing), using better data and analytical tools

**G20/OECD Guidance Note on Diversification of Financial Instruments for Infrastructure and SMEs**, endorsed by G20 Leaders, September 2016
Current and Expected Work on Mobilisation of Finance for LTI

- OECD report (Forthcoming) Blockchain technology as the digital infrastructure enabler
- OECD Blockchain Policy Forum

- 12-13 September 2018 - OECD World Bank Seminar on Quality Infrastructure
- “Mobilising financing for the transition” Chapter 7 of the report “Investing in Climate, Investing in Growth” launched 23rd May 2017, Berlin
- SRI & ESG investing

OECD Long-term Investment

- Mapping of financing flows for energy, water, transport building on G20/OECD Guidance note
- Delivery/financing models (with Singapore MoF)
- Financing innovation
- Country/Project studies (i.e. Brazil)

- Risk mitigation instruments for APEC with GIH (Survey of Mexico, Chile, and Peru)
- OECD/IOPS Global Forum on Private Pensions (Africa)

- Infrastructure data initiative with GIH, WBG, EIB, LTIIA, GLIO & GIAA
- Large pension fund and large insurers survey

Beyond this work, the OECD is active on the governance of infrastructure, blended finance etc.
IMPORTANCE OF DATA FOR INFRASTRUCTURE
Innovation in data analysis, data gaps and OECD Role

• Issues re data gaps in LTI are not new...

• ... but new tools and datasets are available

• Use of micro sources of data (firm/project level) for academic work

• Several OECD Directorates already involved (STD, DAF, ENV, DCD) with ITF and IEA

• Private/public sector interest

• Role of G20/G7/APEC
Impact of climate change

Sources: Times Union, the Atlantic, Electric Literature
Socio-economic impacts of Mega infrastructure projects

Sources: BBC, FILE Afternoon Voices
Impact of Corruption

Odebrecht bribery across Latin America

Bribery payments shown in millions of dollars

- Dominican Republic (2001 – 2014) 92
- Brazil (2003 – 2016) 349
- Mexico (2010 – 2014) 10.5
- Panama (2010 – 2014) 59
- Colombia (2009 – 2014) 11
- Ecuador (2007 – 2016) 33.5
- Peru (2005 – 2014) 29

Source: US Justice Department

© DW
State of Infrastructure

Source: AFP & AP
ESG AND FINANCIAL PERFORMANCE
Why does ESG in investment matter?

ESG as portfolio risk and return factor

- ESG factors potentially important **drivers of portfolio risk and return** due to policy goals and pressure from civil society
- Need for action on regulatory and investor side to **understand and measure ESG-related portfolio risk** and to provide a clear regulatory framework

Examples of ESG issues and their effect on company value

<table>
<thead>
<tr>
<th>Environmental</th>
<th>Social</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate change and carbon emissions</td>
<td>Community relations</td>
<td>Executive pay</td>
</tr>
<tr>
<td>Valuation risk: Future regulation and taxation</td>
<td>Valuation risk: Failure to anticipate social trends, e.g. food company fails to innovate in line with concerns about obesity</td>
<td>Valuation risk: inappropriate reward structure leads to poor long-term decisions</td>
</tr>
<tr>
<td>Air and water pollution</td>
<td>Labour standards</td>
<td>Disclosure</td>
</tr>
<tr>
<td>Valuation risk: Fines</td>
<td>Valuation risk: Reputational damage</td>
<td>Valuation risk: litigation risk if fail to disclose known ESG risks</td>
</tr>
<tr>
<td>Waste management</td>
<td>Health and safety record</td>
<td>Tax strategy</td>
</tr>
<tr>
<td>Valuation risk: Cost of production</td>
<td>Valuation risk: Major accident or interrupted production</td>
<td>Valuation risk: reclaimed taxes, public opinion leads to boycott</td>
</tr>
</tbody>
</table>

* Source: OECD Investment Governance and Integration of Environmental, Social and Governance Factors (2017)*
How may ESG integration be reconciled with investor’s duties?

- Investor perception that ESG integration could not be in line with prudential standards and investor obligations
  - Obligations include: Contractual relationships, duties of care, laws and regulations
  - Clarification from regulatory side that ESG integration is not prohibited as long as it does not jeopardize portfolio performance*

- Traditional portfolio management may systematically underestimate ESG impacts, especially risk imposed to economic growth and financial stability
  - Need for action to clarify impact of ESG integration on prudential standards, risk controls, legal requirements, contractual relationships with beneficiaries etc.
  - Terminology and definitions harmonization in order to promote comparability
  - Quantification in order to ensure integrability in financial modelling

- Evolving views of prudent investment, fiduciary responsibilities and beneficiaries’ interest and evidence of financial impact of ESG related risks and opportunities, e.g. risk of climate change
  - Consideration of technical capabilities and competing priorities
  - Key questions: Integration of non-financial ESG factors and time frame considered (i.e. trade-off between the interests of today’s and tomorrow’s beneficiaries)

- Several policy measures and voluntary initiatives exist, including
  - Reporting requirements
  - Stewardship codes
  - Corporate disclosure
  - Stock exchanges
  - Addressing potential regulatory obstacles

* Clear distinction from ethical investing, as ethical investing other than ESG integration results in reduced financial returns from an investment made in order to support a particular cause

Source: OECD Investment Governance and Integration of Environmental, Social and Governance Factors (2017)
The criticality of data to enable better regulation, unlocking investment

Overall Cumulative Default Rate of Infrastructure (1983 – 2015)

- Moody’s default and loss data has informed Solvency II and Basel III’s adjustment to liquidity requirements for Infrastructure /project finance
- Improved performance data can inform future regulatory capital reforms

Source: Moody's Investor Services
THE G20 INFRASTRUCTURE DATA INITIATIVE
The Infrastructure Data Initiative – Data as a public good

Major attributes of the proposal:
*standardised, centralised and consolidated data on infrastructure assets.*
Global coverage in both developed and emerging markets.
*Collaborative, involving governments, MDBs, IOS, and the private sector*

A joint initiative by all MDBs, GIH, the OECD and private sector associations:

- Argentina compiled a roadmap to infrastructure as an asset class in 2018
- Japan will (re-) adopt a focus on quality and ESG in 2019
A dynamic approach to infrastructure investment analysis...

Sustainability and inclusive growth impacts and climate related risks (i.e. transition risk)

Impact evaluation at project/asset level (utilisation performance, construction costs, and delivery performance)

New benchmarks on investment profitability metrics (Return on assets, return on equity, and dividend yield, default rates and recoveries, etc.)
Developing financial performance benchmarks for infrastructure as an asset class: a proposal

Several OECD monitoring reports and databases provide an increasingly valuable cross-country source of data and information on pension and insurance.

A Proposed template for Data collection

- Project Identifiers
- Business model/Regulatory and Governance
- Debt profile
- Capital structure
- Cash Flows Data
- Construction costs
- Statements/Accounts
- Valuation
- Physical Measures
- Risk Mitigation Instruments

ESG METRICS
## Tentative Timetable

<table>
<thead>
<tr>
<th>Task</th>
<th>Sub-task</th>
<th>Output</th>
<th>Dissemination/Marketing</th>
<th>Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Kick Off</td>
<td>Internal &amp; external staff kick-off</td>
<td>Project team mobilised</td>
<td>Periodic updates to stakeholders, including Steering Group</td>
<td>Nov 2018/March 2019</td>
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<tr>
<td></td>
<td>• Ramp up and development of project team</td>
<td>• Project management and governance agreement</td>
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<td>2. Framework Development Phase</td>
<td>Definition of infrastructure</td>
<td>Develop a Guidance Note on Methodologies for research according to G20 priorities</td>
<td>Feedback from G20/OECD Taskforce on LTI</td>
<td>H1 2019</td>
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<td></td>
<td>• Definition of performance/Benchmarks</td>
<td>• Identify data needs</td>
<td>Feedback from Investors. Research Centres</td>
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<td>• Identify data needs</td>
<td></td>
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<tr>
<td>3. Preferred Template and Standardisation</td>
<td>Create a preferred template of information for financial and non financial data Standardise performance reporting</td>
<td>Document with agreed upon definition of infrastructure, performance, benchmarks and data needs</td>
<td>Presentation to G20/OECD Taskforce on LTI</td>
<td>G20 SUMMIT JAPAN</td>
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<td>4. Data Gathering</td>
<td>Data gathering</td>
<td>Large set of data across assets and time, ready for analysis</td>
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<td>H2 2019</td>
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<td></td>
<td>• Data cleaning</td>
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<tr>
<td>5. IT Development</td>
<td>Third party procurement</td>
<td>Integrated data visualisation of benchmarks</td>
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<td>Start H2/2019</td>
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<tr>
<td></td>
<td>• Mobilisation</td>
<td>• Ability to update benchmarks in the future</td>
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<tr>
<td></td>
<td>• Database creation</td>
<td>• Data visualisation</td>
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<tr>
<td></td>
<td></td>
<td>• Database visualisation of benchmarks</td>
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<tr>
<td>6. Performance Benchmarks</td>
<td>Issue EOI to appoint Strategic Partners</td>
<td>Performance Infrastructure Benchmarks</td>
<td>Presentation to G20/OECD Taskforce on LTI</td>
<td>Dec 2020 onwards</td>
</tr>
<tr>
<td></td>
<td>• Issue EOI to appoint Strategic Partners</td>
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