TRADE UNION ADVISORY COMMITTEE
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ET DE DÉVELOPPEMENT ÉCONOMIQUES

LONG TERM INVESTMENT & ACCOUNTABILITY OF THE INVESTMENT CHAIN: WHAT THE OECD SHOULD DO

TUAC SECRETARIAT
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Introduction

1 Following the 2008 financial crisis and the G20 policy agenda that has unfolded, the OECD has implemented a number of initiatives that relate to long-term investment and/or to investment chain issues.

2 The OECD work on **long-term investment (LTI)** is based on the assumption of a growing gap between future infrastructure needs and traditional sources of funding: public procurement (because of the austerity measures) and bank loans (because of the aftermath of the 2008 banking crisis). Accordingly, institutional investors must step in and diversify their portfolios toward greater exposure to infrastructure (bonds, private funds and direct investment). There surely is room for improvement. According to the latest OECD survey of large pension funds, unlisted infrastructure (i.e. private infrastructure funds and direct investment) accounts for just 1% of total assets.[1]

1. OECD Annual Survey of Large Pension Funds and Public Pension Reserve Funds, 2014 http://www.oecd.org/daf/fin/private-pensions/2014_Large_Pension_Funds_Survey.pdf

3 The OECD approach to LTI is not limited to investment in infrastructure, however. Based on the G20/OECD High Level Principles of Long-Term Investment Financing by Institutional Investors, a long term investment should be defined in a broader sense, and alongside three qualifications – "patient, engaged and productive"[2]:

- **Patient** capital that "allows investors to access illiquidity premia" (i.e. infrastructure investments), "lowers turnover" (i.e. less high frequency and daily trading), encourages less pro-cyclical investment strategies (including less dependence on ratings, and potentially better design of long-term asset management mandates);
- **Engaged** capital that "encourages active voting policies, leading to better corporate governance"; and
- **Productive** capital that "supports infrastructure development, green growth initiatives, SME finance, etc.

4 The concept of an **investment chain** linking the ultimate owners of capital to the invested entities is perhaps less spelled out into stand-alone policy guidance, but it remains crucial to fully appreciate the OECD discussion on LTI. A supply chain follows a private corporation's activities and impact "downstream": suppliers, sub-contractors and outsourcing and consumers. In a very similar way, the investment chain looks at the "upstream" relationships of private corporations: shareholders and creditors, themselves consisting of asset owners (pension funds, insurance companies, and sovereign wealth funds) and asset managers and intermediaries (retail asset management, private funds, investment banking, financial advisory services, etc.). The investment chain consists of four primary levels: financial markets, asset owners, asset managers & intermediation, and invested companies and projects.

Table 1. Policy and regulatory issues along the Investment Chain

Financial markets >	Asset owners >	Management & intermediation >	Invested company & project
Development of debt & equity markets (in developing countries)		Unresolved issues around too-big-fail banks	
Design & public support of infrastructure related & green bonds & private funds ("allowing investors to access illiquidity premia")	Legal and regulatory constraints: tightening of prudential regulations (Basel 2, Solvency 2) and mark-to-market accounting	Legal and regulatory constraints: regulation of private pools (private equity & hedge funds), and of retail managers (UCITS, mutual funds)	
Lack of investable projects and of a stable framework for investment	Governance and design of pension funds (collective vs individual schemes, DB vs DC), Sovereign Wealth Funds & insurance companies.	Accountability of and lack of fiduciary duty guidance of asset managers (acting on behalf of asset owners.	Corporate governance: composition, election, and independence of the board of directors
		Transparency of managers' fees, Investment mandate "ambiguity" design of long term mandates	CEO and executive compensation; Dividend and share-buyback policies
	Design and disclosure of voting policy and records at shareholders meeting; Lack of success metrics for LTI		Corporate financial and sustainability reporting
	Mainstreaming of ESG / responsible investment		Responsible Business conduct
		Transparent and fair risk sharing arrangement in PPPs and other "blending" of private and public moneys	

2. http://www.oecd.org/pensions/private-pensions/institutionalinvestorsandlong-terminvestment.htm

5 The OECD has acknowledged that the lengthening of the investment chain between asset owners and invested companies, as well as the multiplicity and plurality of intermediaries and asset managers, is creating serious complications for policymakers. This policy challenge is to ensure (i) that financial rules do not have unintended consequences for LTI and (ii) proper market transparency and accountability (i.e. the "principal-agent" problem and asymmetric information). For the purpose of illustration, table 1 below shows an indicative list of issues and how they are positioned alongside the investment chain.

OECD initiatives and projects

6 On LTI, OECD work is mainly driven by the G20-endorsed High Level Principles on Long-Term Investment by Institutional Investors agreed to in 2013, which fall under the responsibility of the OECD DAF Financial Affairs division (DAF/FIN) and the OECD Task Force on Long-Term Financing. Chapter-specific "effective approaches" to help implement and observe the Principles are based on country-by-country surveys. An OECD "voluntary checklist" is also currently being circulated to assist countries in self-assessing their LTI framework. Other than the High Level principles, institutional investor governance and management are also dealt in the 2009 OECD Core Principles on Pension fund regulation[3] and the 2011 OECD Guidelines on Insurer Governance.[4]

7 The OECD work on LTI is closely intertwined with the G20 Investment and Infrastructure Working Group (IIWG) which is a creation of the 2014 Australian Presidency of the G20. While the OECD (and its TF on LTI) has responsibility over the High Level Principles specifically, the G20 IIWG has a broader mandate to engage policy discussion on infrastructure, with a strong focus on emerging economies. The B20 is very influential in that group. The most recent deliverable of the IIWG has been the creation of a "Global Infrastructure Hub", to be based in Sydney.

8 Other OECD and G20 projects related to infrastructure include the 2012 OECD Principles on Public Governance of Public Private Partnerships (PPPs) and an upcoming G20-endorsed checklist on institutional investors and PPPs. This work is not led by DAF, but by the separate – and quite distinct – Public Governance Directorate (GOV).

9 On investment chain issues, there are a number of OECD initiatives to consider. First and foremost, the Principles of Corporate Governance are pivotal within the investment chain because they outline the principal-agent relationship between the invested company and the investors (shareholders and creditors). This text dates back to 2004 and is currently being reviewed by the Committee on Corporate Governance and coordinated by the Corporate Affairs division (DAF/CA). The DAF/CA is also coordinating the review of the 2005 OECD Guidelines on the corporate governance of state-owned enterprises under the responsibility of the Working Party on State Ownership and Privatisation Practices.

3. http://www.oecd.org/pensions/private-pensions/33619987.pdf

4. http://www.oecd.org/finance/insurance/48071279.pdf

10 The other important OECD initiative is the on-going application of the MNE Guidelines to the financial sector, which is covered by the Working Party on Responsible Business Conduct, and at the OECD Secretariat, by the DAF Investment Division (DAF/INV). After a first round in 2013 – which confirmed that all shareholders, including minority shareholders, are tied to the business relationship requirements of the MNE Guidelines (see box below), the project is entering a second phase to further explore its effective application in the financial sector. An advisory group will be set up anytime soon. Finally the DAF/CA launched the "Trust and Business" project early 2015. The project is to address "implementation gap in the application of international standards for business conduct" based on the above instruments, as well as OECD Anti-Corruption best practices (DAF/ACD).

11 Several other OECD projects outside DAF have some bearing on investment chain issues, and corporate reporting in particular. For example, the OECD Centre for Tax Policy and Analysis (CTPA) is coordinating implementation of the G20-endorsed Base Erosion and Profiting Shifting (BEPS) Action Plan. One of the key deliverables of the BEPS is the agreement on a new country-by-country reporting framework. The framework was released in February 2015[5]. Table 2 sums up the above mentioned OECD initiatives and where they fit in the investment chain.

Table 2. Distribution of OECD initiatives related to LTI & investment chain issues per OECD Secretariat departments

<table>
<tr><th>INVESTMENT CHAIN:</th><th>FINANCIAL MARKETS ></th><th>ASSET OWNERS ></th><th>MANAGEMENT & INTERMEDIATION ></th><th>INVESTED COMPANY & PROJECT</th></tr>
<tr><td>OECD Dpt:</td><td></td><td></td><td></td><td></td></tr>
<tr><td>DAF / FIN</td><td colspan="3">High Level Principles on LTI</td><td></td></tr>
<tr><td>DAF / FIN</td><td></td><td colspan="2">Core Principles on Pension fund regulation & Guidelines on Insurer Governance</td><td></td></tr>
<tr><td>DAF / CA</td><td></td><td colspan="3">Principles on corporate governance</td></tr>
<tr><td>DAF / CA</td><td></td><td></td><td></td><td>Trust & Business</td></tr>
<tr><td>DAF / INV</td><td></td><td></td><td>application to the financial sector</td><td>MNE Guidelines</td></tr>
<tr><td>GOV</td><td></td><td colspan="2">(upcoming) G20 Investor checklist on PPPs</td><td>Principles on Public governance of PPPs</td></tr>
<tr><td>CTPA, DAF/ACD</td><td></td><td></td><td></td><td>Non-financial reporting requirements</td></tr>
<tr><td>G20 IIWG:</td><td>Global Infrastructure Hub (Sydney)</td><td></td><td></td><td></td></tr>
</table>

5. http://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf

What is missing

12 The OECD instruments related to LTI and investment chain issues as discussed above have to a large extent been designed and implemented in parallel by their respective OECD divisions and committees with little coordination between them. The result is a lack of coherence. A case in point is the integration of environment and social criteria (or even "non-financial" criteria) in the risk management policy of investors. The answer by the OECD is unclear when looking at the specific and as shown in box 1.

13 The problem is not confined to a lack of internal coherence within the OECD. It also relates to the overall ambition of the OECD instruments. In our view they do not sufficiently reflect on central investment chain issues, including:

- how responsible investment practices underpin long-term investment and hence curb short-termist market behaviour;
- the distribution of wealth within the investment chain and its impact on income inequality;
- the pivotal role of asset managers, their accountability to asset owners and regulators and the design of their investment mandates;
- the distribution of risk (and reward) whenever public money is spent to support to private finance as is the case of PPPs.

14 The High Level Principles on LTI provide useful guidance on how to remove regulatory and market barriers that prevent institutional investors from engaging in long-term investment strategies. They do not however sufficiently address the otherwise widespread practice of integrating environmental, social and governance (ESG) criteria as well as tax risks in the investment policy – despite these gradually becoming the norm as seen by the visibility and growing use of the UN Principles for Responsible investment.

15 The Principles of Corporate Governance, and the on-going review process, are even more disappointing. The revision proposal, made public in December 2014, does not recognise any form of responsible investment practices, or even any form of responsibility for shareholders as discussed in the box below. More broadly, the Corporate Governance Principles treat the rights of "stakeholders" (including workers) in a minimalist way that is far below the expectations laid down in other OECD instruments, including the MNE Guidelines.

Box. Should investors integrate environment and social criteria in their risk management policy framework? The answer by the OECD is unclear.

Based on the High Level Principles on LTI, they should. Principle 3.4 states "The governing body of an institutional investor should ensure that the institution can properly identify, measure, monitor, and manage the risks associated with long-term assets as well as any long-term risks – including environmental, social and governance risks - that may affect their portfolios".

For the MNE Guidelines, the answer is yes, although indirectly. The revised 2011 MNE Guidelines state that "Enterprises should carry out risk-based due diligence to identify, prevent and mitigate actual and potential adverse impacts and account for how these impacts are addressed". Impacts here are understood to include social, human rights and environmental impacts. Risk-based due diligence should apply to the entire "business relationship"[6]. Recent OECD guidance on the application of the Guidelines to the "financial sector" (including investors), clarifies that shareholders, including minority shareholders, qualify as a "business relationship".[7]

6. OECD Guidelines for Multinational Enterprises, Chapter II, paragraph 11 & 12

7. https://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/GFRBC-2014-financial-sector-document-2.pdf

For the Corporate Governance Principles however, the answer is far from clear and, by omission, can be understood as negative. The current version of the Principles (2004) is silent on the topic. In the revision proposal, posted on the OECD website[8], chapter III covering "Institutional investors, stock markets, and other intermediaries" is supposed to deal with investors' "active ownership". However, there is nothing in the chapter that would suggest integration of environmental and social criteria in investor risk management. Chapter VI on the responsibilities of the Board of directors (which would also apply to the governing body of investors), is equally silent concerning environmental and social risk management by the Board (Principle D.1[9] and D.7[10]).

16 Little attention is paid to the *distribution of wealth and of compensation within the investment chain and its impact on income inequality*. While the OECD acknowledges that executive compensation has been a driving force in the growth of inequality and top income shares from an economy-wide perspective[11], it is silent on its implications at firm and corporate governance level. Neither the Principles of Corporate Governance nor the High Level Principles on LTI raise concern about the dangers of excessive executive compensation for the long-term interest of the company. In the same vein, nothing is said about excessive shareholder remuneration through dividends and "share buyback" programmes that hinders the company's capacity to reinvest retained earnings and sustain economic growth.

17 The remuneration of financial intermediaries, and the *design of asset managers' mandates*, is also of concern. Overall poorly designed remuneration schemes throughout the investment chain not only increase the cost of capital and reduce investment returns of asset owners, they also fuel broader income inequality – as wealth creation is diverted by financial intermediaries at the cost of the real economy – and short-termist market behaviour. The accountability and transparency of asset managers and other financial intermediaries, given their central role in the allocation of capital in the investment chain, is poorly dealt with in both the High Level Principles on LTI and the corporate governance Principles.

18 *Public support to private finance* – including government guarantees on private securities, first equity losses in venture funds and PPPs – can have a role in promoting long-term investment strategies. The OECD however should not fall into blind enthusiasm for "blending" or "leveraging" private finance with public money. Strict transparency rules and fair risk-sharing arrangements should prevail to prevent situations where gains are privatised, while losses are socialised. Serious concerns remain about PPP schemes financing infrastructure and services, because of the complexity of the contractual arrangements (as compared to traditional public procurement), the unequal and uncertain distribution of risks between the government and private investors and because of the threats posed to public services.

8. http://www.oecd.org/daf/ca/OECD-Principles-CG-2014-Draft.pdf

9. "Reviewing and guiding corporate strategy, major plans of action, risk management policy policies and procedures (…)"

10. "Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards"

11. .Top Incomes and Taxation in OECD Countries: Was the crisis a game changer? OECD May 2014 http://www.oecd.org/social/OECD2014-FocusOnTopIncomes.pdf

What the OECD should do

19 The TUAC welcomes and supports the OECD work on LTI, but with a number of caveats. The OECD should engage a far more comprehensive approach to the governance and accountability of the investment chain than what is currently implemented through separate projects and initiatives.

- First of all, responsible investment should become a central pillar of the OECD work on long term investment. To the three qualifications that currently define the OECD approach – "patient, engaged and productive capital" – a fourth one needs to be added: "responsible".
- Secondly, more work remains to be done on the distribution of financial wealth within the investment chain and the transparency and accountability of asset managers and bankers in particular.
- Thirdly, a cautious and indeed long term view should prevail whenever public money is spent to support private finance, which would require strict rules on fair and transparent risk-sharing.

Key weblinks

TUAC (& ITUC/L20)

09/02/2015 | L20 Priority Recommendations to the G20 Finance Ministers, February 2015 http://www.tuac.org/en/public/e-docs/00/00/0F/DC/document_doc.phtml

01/12/2014 | TUAC Ad Hoc meeting on Pension reforms http://www.tuac.org/en/public/e-docs/00/00/0F/A1/document_doc.phtml

28/10/2014 | The impact of financial reforms on the business model of banks and their social implications: a dialogue between the Finance Stability Board, business leaders and union leaders http://www.tuac.org/en/public/e-docs/00/00/0F/64/document_doc.phtml

13/10/2014 | TUAC Submission on the Review of the Principles of Corporate Governance http://www.tuac.org/en/public/e-docs/00/00/0F/7C/document_doc.phtml

23/07/2014 | L20 Submission to the G20 Investment and Infrastructure Working Group, 4 June 2014, Singapore http://www.ituc-csi.org/l20-submission-to-the-g20

05/03/2014 | OECD Task Force on Institutional Investors and Long Term Financing: TUAC Submission http://www.tuac.org/en/public/e-docs/00/00/0E/42/document_doc.phtml

16/10/2013 | Economic Briefing: A review of the G20 agenda on tax avoidance and on long-term investment http://www.tuac.org/en/public/e-docs/00/00/0D/83/document_doc.phtml

OECD:

DAF/FIN

Institutional investors and long-term investment http://www.oecd.org/pensions/private-pensions/institutionalinvestorsandlong-terminvestment.htm

DAF/CA

2014-2015 Review of the OECD Principles of Corporate Governance http://www.oecd.org/daf/ca/2014-review-oecd-corporate-governance-principles.htm

OECD Trust and Business (TNB) Project http://www.oecd.org/daf/ca/trust-business.htm

DAF/INV

Guidelines for MNEs - Responsible business conduct in the financial sector http://mneguidelines.oecd.org/rbc-financial-sector.htm

GOV

Principles for Public Governance of Public-Private Partnerships http://www.oecd.org/governance/budgeting/PPP-Recommendation.pdf

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