Insurance Europe comments on OECD draft high-level principles of long-term investment financing by institutional investors

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Insurance Europe, the European insurance and reinsurance federation, welcomes this opportunity to provide comments on the OECD Draft High-Level Principles of Long-Term Investment Financing by Institutional Investors. Insurance Europe supports the substantial work developed by the OECD on long-term investment and looks forward to further contributing to it.

At European level, insurers are the largest institutional investors, managing € 7.7trn assets at the end of 2011. Insurers' significant role as investors is a consequence of their primary role of providing protection from risks, as well as long-term savings and retirement products. The main driver of insurers' investment decisions is the profile of their liabilities. As most of their liabilities are long-term, investing with a long-horizon perspective becomes a natural match between insurers' assets and their liabilities. At the same time, a range of framework conditions and policy actions can shape and impact the way in which insurers invest.

Against this background, Insurance Europe welcomes the G20 initiative and appreciates that the principles on long-term investment should be able to capture the fundamental elements of long-term financing in a sufficiently high-level, accessible and balanced way, based on sound economic principles.

General feedback on the proposed draft principles:

- Alongside encouraging long-term investments, governments should continuously monitor individual and cumulative effects of existing and under development regulations in order to identify and address any biases against long-term investment.
- However, any government intervention must be balanced against market mechanisms in a way that does not distort the functioning of the markets.
- The development of long-term savings should be promoted by governments through savings mobilisation policies, such as automatic enrolment mechanisms or other types of incentives.
- Governments should not only promote the development of long-term savings, but also create an environment that ensures trust and stability for those willing to invest long-term.

Specific detailed comments on the draft principles:

Draft Principle 1: Preconditions for long-term investments

1.1 Governments[1] should put in place framework conditions that are favourable to long-term investment financing. In particular governments should continuously monitor individual and cumulative effects of existing regulations and regulatory developments in order to identify and address any biases against long-term investments. When evaluating policies to promote long-term investment by institutional investors, policymakers should consider its wider potential public impact, societal returns and externalities, while ensuring its consistency with the best interest of members, beneficiaries, policyholders and other relevant stakeholders. In particular, long-term investment can help achieve broader policy goals such as financial stability, debt sustainability, job creation, inclusive growth and higher living standards, competitiveness, and sustainable economic development. However, any government intervention must be balanced against market mechanisms in a way that does not distort the functioning of the markets.

1.2 Governments should ensure that capital markets and financial intermediaries are subject to an appropriate regulatory and supervisory framework. Policies to promote long-term investment by institutional investors should be consistent with prudential objectives, ensuring the security, quality, liquidity, and profitability of the overall investment portfolio. Tax neutrality towards different forms of financing should be promoted~~.~~ (for example, equity investments should not be overburdened by double or multiple taxation).

1.3 A favourable business and investment climate and the effective observance of the rule of law are essential for long-term investment. Governments should create transparent, fair, consistent and reliable business regulation and supervision and administrative procedures. This principle is of particular importance when private companies are mandated to provide services which are of general interest. In particular, policies are needed to facilitate the establishment and growth of new firms and small and medium-sized companies. They should also promote an effective framework for fair competition and corporate governance.

1.4 Governments should create the necessary legal and institutional preconditions for the development of institutional investors with a longer term investment horizon. Such investors should be adequately regulated and supervised, taking into account their specificities and in line with relevant international standards.

1.5 Governments should develop and publish their long-term investment plans, consistent with a sound fiscal framework, after carrying out a suitable socio-economic impact assessment of projects. These investment plans and their associated regulatory, judicial, and tax environment should be transparent, consistent and contribute to sustainable development and growth, including green growth.

1.6 Where appropriate, governments should provide opportunities for private sector participation in long-term investment projects such as infrastructure and other relevant projects via, for instance, public procurement and public-private partnerships. Proper planning of such initiatives is recommended in order to ensure a regular project pipeline. These structures should be supported by a transparent and

[1] Government is defined broadly, including all competent authorities at international, national and sub-national level.

sound monitoring, accountability and regulatory framework. They also require capacity building in government at both the national and local level.

1.7 Government should consider issuing appropriate long-term instruments in line with their debt management and capital market development objectives. Such instruments underpin the development of long-dated private sector securities markets and can support asset-liability management by institutional investors and complement long-term investment portfolios.

Insurance Europe proposes adding 1.8:

1.8 In order to limit uncertainty and to safeguard a stable environment for long-term investments, governments should take into account the impact of possible changes to the regulatory frameworks on both past and future investment decisions.

Draft Principle 2: Development of institutional investors and long-term savings

2.1 Governments should promote policies that support the development of institutional investors and their role in long-term investment financing in a sound and sustainable manner.

2.2 Governments should promote the development of long-term savings through savings mobilisation policies. Such programmes should consider the use of default mechanisms such as automatic enrolment ~~as well as, where appropriate, mandatory arrangements.~~or other types of incentives to develop such savings. When relevant, appropriate financial incentives to long-term saving should be provided and tax impediments removed. Governments should also promote the development of long-term savings through increased awareness amongst the population, financial inclusion policies, and the promotion of financial literacy.

Insurance Europe proposes adding 2.3:
2.3 Governments should not only promote the development of long-term savings, but also create an environment that ensures trust and stability for those willing to invest in long-term financial commitments.

Draft Principle 3: Governance of institutional investors, remuneration and asset management delegation

3.1 The governing body of institutional investors should ensure that the investment strategy of the institution is ~~designed~~ taking into account the profile of its liabilities and follows the prudent person principle.

3.2 The governing body of institutional investors ~~should have the right mix of skills to design, assess, monitor, and review long-term investment strategies.~~

~~3.3. When~~ deciding to invest in long-term assets~~, the governing body should~~ needs to ensure that it collectively understands those investments and their associated risks and that the investment management personnel of the institution has the necessary ~~capability (possibly through outsourcing, though retaining full responsibility)~~expertise to design, assess, monitor, and review investment strategies for long-term assets, to implement the strategy and manage those investments in line with the institution's objectives. When outsourcing to external asset managers is being used, the institution should retain full responsibility for the investment decisions.

3.~~4~~3 The governing body of institutional investors should ensure that conflicts of interest that may affect their investments, including any long-term assets, are identified and addressed.

3.~~5~~4 The governing body should ensure that the institution can properly identify, measure, monitor, and manage any risks associated with long-term assets as well as any long-term investment risks – including environmental, social and governance risks - that may affect their portfolios.

3.~~6~~5 The governing body of institutional investors should observe its fiduciary duties towards the ultimate owners or beneficiaries of the assets they deal with. Such duties should include the prudent and efficient management of any long-term assets and the informed and effective use of their investor rights, including shareholder rights. Those persons and entities involved in the management of the assets of institutional investors should act in consistency with those fiduciary duties.

3.~~7~~6 The performance of fund managers should be evaluated over a period of years, taking into account asset-liability management objectives and the level of risk implicated. Performance-based elements of fund managers' remuneration should be based on long-term criteria.

3.~~8~~7 Regulatory and supervisory authorities overseeing institutional investors and other actors within the investment management chain should monitor the governance, agency relationships, and risk management mechanisms underpinning long-term investment and take prompt and adequate measures when relevant. They may also provide guidance to institutional investors regarding the governance and risk management requirements to meet long-term investment objectives.

Draft Principle 4: Prudential regulation, valuation and tax treatment

4.1 The prudential regulatory framework - including valuation rules and any risk-based capital requirements - for institutional investors that have a long-term investment horizon should reflect the risks inherent to long-term assets appropriately. The framework should also consider the investment horizon of these investors, while promoting their soundness and solvency as well as broader financial stability and consumer protection. Excessive or mechanistic reliance on external information providers (such as credit rating agencies) should be avoided.

4.2 Any solvency or funding requirements for institutional investors should aim to be countercyclical and avoid creating incentives for procyclical investment strategies. Risk-based solvency rules should consider the suitability of long-term assets for asset-liability management purposes. Equally, accounting principles should provide the true economic reality.

4.3 The transparency, standardization and accuracy of valuation methods for long-term assets should be promoted. Valuation measures should take into account the inherent long-term economic value of the business undertaken. Therefore valuation methods other than observable market prices could be appropriate. In such cases, governments should guarantee that the frameworks in place ensure the transparency of the valuation approaches.

4.4 The tax environment and policies should create no impediment to long-term investment by institutional investors and be subject to regular monitoring to prevent abuse, in particular in terms of international competition.

4.5 Governments should collaborate to strengthen the regulatory and supervisory frameworks for institutional investors and promote greater consistency, which may facilitate open, free and orderly capital flows and long-term cross-border investment by institutional investors.

Draft Principle 5: Financing vehicles and support for long-term investment and collaboration among institutional investors

5.1 Public intervention in long-term investment projects should be optimised by identifying any market failures, carrying out appropriate cost-benefit analysis of such interventions and ensuring that any public support is appropriately priced and subject to fiscal considerations.

5.2 Governments may consider providing risk mitigation to long-term investments projects where it would result in more appropriate allocation of risks. Such risk mitigation mechanisms may include credit and risk guarantees, first-loss provisions, public subsidies, and the provision of bridge financing via direct loans.

5.3 Regulatory authorities should establish the necessary regulatory framework for pooled investment vehicles and securities channelling financing for long-term investment in a sound and sustainable manner.

5.4 In markets with limited presence by institutional investors, governments, national development banks, and multilateral development agencies should consider establishing and promoting pooled vehicles for long-term investment, and other instruments for long-term investment such as project bonds. Such investment vehicles should have an investment horizon in line with those of the underlying projects.

5.5 Governments should establish a policy environment to address any market failures which are preventing long-term investment by institutional investors in new and young firms with a high growth potential, and more generally in small and medium-sized companies. Where appropriate, they should provide seed capital to such firms utilising competitive processes and private sector expertise and establish suitable financing vehicles.

5.6 Collaborative strategies and resource pooling amongst institutional investors and with other financial institutions should be encouraged and supported in order to facilitate the exchange of know-how and to allow sufficient scale and diversification to be reached for investment in large, long-term projects.

Draft Principle 6: Investment restrictions

6.1 Where applied, investment restrictions should be consistent with diversification, prudential and financial regulation objectives and should not prevent long-term investment by institutional investors. They should be reviewed regularly and, where appropriate, any restrictions on long-term investment by institutional investors should be ~~eased~~ removed subject to necessary safeguards being in place, such as strong governance and risk management mechanisms - as part of the prudent person standard - and effective supervision.

6.2 Governments should avoid introducing or maintaining barriers to international investment – inward and outward - by institutional investors, especially when targeted to long-term investment and they should cooperate to remove any related international impediments, when possible.

Draft Principle 7: Information sharing and disclosure

7.1 Data collection on long-term investments and their performance should be promoted at both the national and international level subject to cost and efficiency considerations. Such data collection can facilitate monitoring by supervisors, enhance the knowledge of institutional investors, reduce information asymmetries and improve the functioning and liquidity of markets.

7.2 Governments and international organisations should consider promoting the establishment of an international information platform accessible to investors that would provide comparative information on existing or foreseen long-term investment projects.

7.3 Institutional investors should be encouraged to disclose information on the extent to which their investment strategies are in line with their investment horizon and the extent to which they address long-term risks.

7.4 Institutional investors should be ~~required~~encouraged to report their past allocation to and performance of different assets – including long-term investments - following a standardised classification, while ensuring the confidentiality of any market-sensitive information. The reporting ~~should~~could have an appropriate frequency and ~~should~~could include performance measures calculated over sufficiently long periods. Such information should be at least available for members, policyholders and other beneficiaries as well as supervisory authorities. In order to fulfill disclosure requirements, adequate existing reporting sources should be used as much as possible.

~~7.5 Long term investment by institutional investors should be regularly monitored by the competent authorities.~~

Draft Principle 8: Financial education, awareness and consumer protection

8.1 An appropriate financial inclusion and consumer protection framework should promote long-term investment by institutional investors serving the retail market and to protect stakeholders, policyholders and beneficiaries of institutional investors in relation to such long term investment.

8.2 Tailored financial education and awareness strategies programmes should be put in place to inform potential and actual users of institutional investment vehicles about the benefits of long-term saving and investing, as well as any potential risks and costs.

8.3 Default investment mechanisms in line with the average consumers' investment objectives and risk preferences could be put in place in retirement savings systems.~~ that are consistent with the members' objectives, risk preferences and time horizons.~~