

Institutional Investing: A New Investor Forum and Growing Interest in Sustainable Emerging Markets Investments

By Svetlana V. Klimenko, Eric Bouyé and Morten Lykke Lauridsen

Achieving the Sustainable Development Goals is estimated to require additional financing on the order of \$2.6 trillion in emerging markets and low-income countries in 2030. A substantial increase in private investment is required to close this financing gap. Fortunately, institutional investors—who control the magnitude of funds needed—increasingly see sustainable, long-term investing and allocations in infrastructure as intriguing prospects. These investors face challenges to realize these opportunities, however. The Investor Forum held at the 2018 G20 Buenos Aires Summit, which included some of the world's largest investors, focussed on solutions to these challenges. The resulting Buenos Aires Call to Action calls for a more regular dialogue with policy makers at the highest level and underlines the need to break away from the short-termism that plagues current investment strategies. It also highlights a series of concrete actions designed to increase the flow of sustainable long-term investments.

According to new research from the IMF, there is a need to substantially increase spending and investments in developing countries to achieve the Sustainable Development Goals (SDGs).¹ The financing gap in 2030 is estimated at \$500 billion in low-income countries and \$2.1 trillion in emerging markets, which represent some 15 percent and 4 percent of GDP in these countries, respectively.

As stated in the UN Addis Ababa Action Agenda on Financing for Development, private investments can play a key role in closing the development financing gap.² A key challenge in this regard is attracting private institutional investors, who collectively manage the trillions of dollars needed to realize the SDGs.

While institutional investors are indeed interested in long-term investments that support sustainable economies,

and view the SDGs as a useful framework for future collaboration between the public and private sectors, they also have important considerations that are rarely brought to the forefront in global discussions on development finance. This was in evidence at the G20 Investor Forum, where over 40 leading institutional investors met with finance ministers and international financial institutions to discuss sustainable long-term investing and scaling up investments in infrastructure.³

The Investor Forum

To augment the voice of investors, the first ever high-level Investor Forum was held at the 2018 G20 Buenos Aires Summit. The Forum was hosted by the Government of Argentina and the World Bank Group, with participation from investors with combined assets under management of

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Investor Forum, November 2018, G20 Summit, Buenos Aires, Argentina. Photo: World Bank Group

more than \$20 trillion. The Forum led to the adoption of the Buenos Aires Call to Action, which identifies tangible steps to boost long-term, sustainable private investments that can tackle development challenges and promote economic growth.

Key messages from Buenos Aires

Several key messages emerged at the Investor Forum and are reflected in the Buenos Aires Call to Action.⁴ Highlights on infrastructure investing and sustainable investing from the dialogue include:

Infrastructure Investing

1. Governments will require substantial assistance and expertise to frame long-term visions, develop bankable investment programs, structure projects in a way that appropriately allocates risk, and carry out transactions in a transparent and well-governed way. Bankable infrastructure investments should start with a clear vision about what infrastructure assets are needed to deliver desired services and how those will be paid for in a particular social and economic context. Delivering resources through multilateral and national facilities will help foster the development and use of standards that can reduce transactions costs.
2. Co-investment platforms play a central role, but they could be more effective and have a greater catalytic effect if they engage local investors and if governments

align their policy and regulatory frameworks for long-term infrastructure financing. There is a need to broaden the scope of co-investment platforms to include and incentivize a greater role for local institutional investors. Stronger local engagement can help to reduce political risk for international investors. Scaling up private investments in infrastructure in emerging markets requires further expanding the investor base. IFC's MCPP Infrastructure and IBRD's proposed "Infrastructure Loan Refinancing Facility" are good models for mobilizing private investors.

Sustainable Investing

1. Governments could increasingly support private sector-led efforts to rationalize corporate disclosure to promote long-term investing and value creation. Specifically, this would involve: identifying and consolidating existing, relevant environmental, social, and governance (ESG) disclosure standard-setting; promoting investor use of such consolidated disclosures, which includes quantitative and qualitative information; eliminating any regulatory barriers to the agreed disclosures; and over time, incorporating these disclosures into international accounting standards (International Financial Reporting Standards and U.S. Generally Accepted Accounting Principles).
2. National and international regulators and supervisors of banking, insurance, securities, and pension funds should work together with investors to clarify

and promote the idea that fiduciary duty requires integration of material ESG factors into investment processes. Further improvement of disclosure of material ESG information—via Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) etc.—is critical, and quality, reliable, public data is needed. At present, legal liabilities are hampering this in some developed countries. Emerging markets may have an opportunity to leapfrog and establish better regulations, avoiding these sorts of legacy issues.

3. **To expand impact investing it is important to adopt harmonized operating principles and practices.** The creation of a standard for impact investing will bring discipline to the market and help investors identify and distinguish impact investments from other types of investments. Impact investing should be recognized as a strategy that combines both financial return and impact objectives based on the growing evidence that there does not have to be a trade-off between the two. There is growing evidence that benefits for society and the planet on the one hand, and financial benefits for policy holders on the other, are not mutually exclusive and can in fact be complementary.

A Survey of Investors

Investors face constraints for sustainable investing and scaling up allocations to infrastructures, yet those constraints are generally not centered on concerns about SDG investments underperforming other assets.⁵ In fact, most investment executives do not share the perception that sustainable investing involves lower returns. Instead the biggest hurdle to sustainable investing is the lack of a framework that can bring it into mainstream investing. These barriers could be partly overcome through local authorities' commitment to policies and regulations aligned for sustainable long-term financing, identification of local partners in emerging markets who can navigate and manage the local political environment, and better information and data about the investment opportunities in emerging markets, including in infrastructure.

Those are some of the important messages garnered from interviews the World Bank Group conducted in preparation for the Investor Forum with senior executives—mostly chief executive officers and chief investment officers—from 34 global institutional investors.

The major topics covered in the interviews were: (i) current perceptions regarding today's economic and investment environments; (ii) mega-trends shaping existing and future investment strategies; (iii) sustainable investing along multiple dimensions; (iv) infrastructure investing; (v) investing in emerging markets; and finally, (vi) the potential role of the World Bank Group and by extension other international financial institutions (IFIs).⁶

Given the geographic diversity, number, and seniority of the interviewed executives, the interviews can be considered a reflection of views widely held by the global investment community. Overall, the interviews revealed a significant degree of consensus among global investors on the principal concerns, opportunities, and actions needed.

The investors noted two significant drivers of change. The first of these is the shift toward sustainable investment practices—including the adoption of environmental, social, and governance principles in investing—which result in part from consumers and employees who want to work for and do business with companies with good ESG practices. The second driver of change is a growing recognition among companies that their investment decisions have real systemic and sustainability implications. International attention to the Sustainable Development Goals supports this trend and makes it increasingly difficult for investors to turn a blind eye to the impact of their investment decisions.

While there was no consensus among the interviewed investors about what constitutes sustainable investing—views covered a continuum from negative/exclusionary screening to ESG criteria/performance to impact investing—all executives were interested in it and stated that their funds were practicing sustainable investing to various degrees and in different ways.⁷

Sustainable Investing—Opportunities and Challenges

Interview respondents identified the advancement of sustainable, long-term investing as an area of significant interest and opportunity. The trend toward sustainable investing was associated with changing perceptions about the role of private corporations in society. While all respondents still saw creating value for shareholders as fundamental, ideas about the best ways to go about it are changing.

Several respondents cited the report issued by the European Commission's High-Level Expert Group on Sustainable Finance, which begins with the notion that the purpose of finance is to serve the real economy, rather than being an end to itself.⁸ Furthermore, respondents highlighted a number of common observations, including: (i) a longer-term focus in investment decision making; (ii) a desire to support sustainable economies; (iii) the changing role of private corporations in societies as “universal owners” that take system-level views; (iv) the rising voice of members of the Millennial generation, many of whom want their money managed for purpose as well as for profit; and (v) increasing attention to the SDGs.

Long-termism was highlighted as a major theme in the interviews and it touched on several related topics. Many investors were aware of and involved in initiatives focused on getting both companies and investors to take a longer-term view when making and evaluating their investment decisions. Engagement and stewardship were discussed as tools to

ensure that portfolio companies have sustainable long-term strategies in place. Some respondents highlighted the importance of supporting engagement strategies via changes to the fee structures, timeframes, and performance metrics in contracts between asset owners and asset managers.

Most respondents declared that they used ESG standards for mainstreaming sustainable investing. All respondents viewed ESG integration as a good way to mitigate downside risk; some also felt that it was a source of upside opportunities by identifying companies with good or improving ESG performance. Many interviewees cited a lack of high-quality and comparable data on companies' ESG performance as a major barrier to better ESG integration, and some called for standards for nonfinancial reporting. Ideally, it was felt, all companies should be required to report on their nonfinancial performance according to a set of standards, just as listed companies are required to do for their financial performance.

Several respondents pointed out the need for a balance between generations so that returns earned for current generations do not inhibit the returns that can be earned for future ones. A long-term view takes account of the effect of investment decisions on future generations. Most of the interviewees—particularly pension funds that have long-tailed liabilities—raised this strategic imperative. In the same vein, several respondents discussed how the growing wealth and voice of Millennials is putting pressure on them to create investment products that both earn required returns and contribute to a sustainable world.

According to the interviews, there is substantial variation in the extent to which the 17 SDGs are de facto influencing investment strategies, although all respondents were familiar with them. Some investors said they were using them as the basis for sustainability-themed strategies such as climate and low carbon, water scarcity, and food security. Those doing so pointed out that 17 goals are a large number, so they had created themes by combining the relevant elements of different SDGs. Others expressed skepticism about whether the SDGs lent themselves to creating or influencing investment strategies. Despite this variation, there was a consensus that the SDGs were a useful framework for thinking about collaboration between the public and private sectors.

There were many references to the value of creating the necessary market standards of nonfinancial performance metrics and pricing mechanisms for positive and negative externalities. This could help to adjust capital allocation to reward companies that are creating long-term shareholder value. The Global Reporting Initiative and the Sustainability Accounting Standards Board were cited as leading the work to create ESG measurement and reporting standards at the company level. The World Benchmarking Alliance was cited as having the potential to contribute to standardizing impact measurement through benchmarking.⁹ Respondents generally felt that,

as sustainable investing is going mainstream, so should the efforts to introduce market-level adjustments to create a level playing field in this new era.

Infrastructure—Opportunities and Challenges

The institutional investors interviewed expressed considerable interest in infrastructure investing. In the post-2008 environment, the traditional bank-centric intermediation was shifting toward a system in which institutional investors play an increasingly important role in providing long-term capital. Many of the respondents said they were trying to figure out how to become successful players in this space.

Infrastructure investment is seen as attractive for many reasons. In the right environment, infrastructure assets can provide a hedge against inflation, generate stable cash flows, and help buffer returns in a financial crisis. The investors saw the bigger-picture need to invest in sustainable infrastructure to mitigate pressures in coming decades to adjust to global megatrends such as aging, migration, global warming, inequality, and urbanization. Many respondents said they would like to increase their investment allocations to infrastructure, but also said they are struggling to find ways to do so.

When asked about constraints, respondents highlighted their investment requirements. These include stable cash flow, moderately low risk, acceptable rates of return, and assets that hold a credit rating. Many infrastructure projects don't meet these requirements. Furthermore, three main constraints were highlighted.

First, the pipeline of bankable projects is limited, and the perception is that public investment sometimes crowds out the private sector. The size of available projects is also important because large investors need to invest in large increments. Detailed feasibility studies and robust business cases are important to attract investors, who require high-quality information on which to base investment decisions.

Second, investing in infrastructure often implies new and unproven investment environments that entail high transaction costs. This introduces uncertainty and risks that are difficult for investors to manage. The lack of standardized documentation, benchmarking, and performance data for the sector is seen as contributing to these transaction costs, and to the overall market "ambiguity" on how to treat investments in infrastructure.

Third, financial and prudential regulations disincentivize long-term investing due to their high capital requirements, independent of the underlying investment risk. Many respondents felt that existing financial and prudential regulations fail to accommodate the needs of infrastructure investing by institutional investors. The regulations ignore the particularly long-term nature of the liabilities of certain institutional investors (for

example, pension funds, which need the capacity to sustain their positions for long durations) and the needs of infrastructure financing.

Investing in emerging markets is seen as particularly complex, with higher business, political, and currency risks, insufficient information about existing opportunities, and often a lack of institutional capacity in public and private contractual counterparts. Recognizing that this complexity will be a reality for the foreseeable future, many investors emphasized the importance of finding local partners in emerging markets who know how to navigate and manage the local political environment.

Some institutional investors who were interested in investing in emerging markets stated that they lacked information about opportunities, as well as the necessary in-house skills and time to gather it. A few referred to unsuccessful past experiences, but most were still interested in these types of investments. Scaling up investments in emerging markets required finding the right partnerships and financial solutions to mitigate risks. A few of the respondents were successfully working with IFC's Managed Co-Lending Portfolio Program (MCPPI).

Going Forward

The inaugural Investor Forum in Buenos Aires demonstrated the importance of bringing the “supply” side of global finance—represented by large institutional investors usually domiciled in advanced economies—into conversations with the G20 that focused on sustainable development. Going forward, direct involvement, buy-in, and articulation of views from global investment leaders will be critical for successful implementation of the Sustainable Development Goals. Dialogue with G20 governments and international financial institutions enables these investment leaders to emphasize the potential of what could be achieved through their participation, and to identify specific opportunities for the way forward.

The Forum also highlighted a gap in the engagement strategies with the private sector. The primary focus has traditionally been on the “demand” side—through creating markets and enabling environments in recipient countries. But the “supply” side is equally important. The proverbial trillions of dollars needed are concentrated in the hands of a relatively few institutional investors. For them to act and to invest their capital where it is most needed, they need to not only know where these opportunities are, but also to be able to move forward within their regulatory environments.

Going forward, there is a need to rethink how engagements should be built if the SDGs are to be realized by 2030, given the need for substantially increased investments. Discussions in the G20 can provide a strong forward-looking platform for action and ensure a regular dialogue between policy makers and investors at the highest level. G20 governments are uniquely placed to host an ongoing conversation with the private sector, and investors in turn are keen to continue the dialogue.

Some of the biggest contributions on the part of Multilateral Development Banks may come in the form of platforms for mobilization, standards, and procedures—incorporating principles of sustainability and long-termism in their design.

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¹ IMF Staff Discussion Note. 2019: “Fiscal Policy and Development: Human, Social and Physical Investments for the SDGs.” SDN/19/03.

² United Nations. 2015. https://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

³ Sustainable investing encompasses both corporate social responsibility, or CSR, which describes a company's commitment to socially responsible practices, as well as environmental, social and governance, or ESG, practices.

⁴ For the full text of the Buenos Aires Call to Action (WBG, 2018) see: <http://www.worldbank.org/en/news/feature/2018/11/29/buenos-aires-call-to-action-shaping-the-future-of-global-private-and-public-investments>

⁵ Sustainable investing is about investing in companies and projects that will grow the real economy because they are profitable, they minimize negative externalities, and they maximize positive externalities. In turn, sustainable investing promotes sustainable development. Sustainable investing is often used as an umbrella term for a variety of investing styles that evaluate companies on ESG factors alongside traditional stock-picking metrics.

⁶ For a full report on investor perspectives refer to World Bank Group. 2018. “The Landscape for Institutional Investing in 2018.” <https://openknowledge.worldbank.org/handle/10986/30901>

⁷ For more details on the continuum of strategies for sustainable investing refer to the full report cited in endnote 4.

⁸ “Final Report of the High-Level Expert Group on Sustainable Finance.” 2018. https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en

⁹ “Benchmarking Companies as a Driver for Change.” 2019. <https://www.worldbenchmarkingalliance.org/>

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