## Sustainable Investment Strategies

Due to the diverse group of investors on the panel, the discussion turned broadly to the potential role of SWFs, development banks, and other long-term investors in a country's industrial policy. Panelists noted that the role of sustainable investment strategies in such policy was dependent on each country's particular conditions.

**Aaron Chartterji**, Associate Professor of Business at the Fuqua School of Business at Duke University, moderated the session and began by framing the discussion in terms of the potential role for sovereign wealth funds and other long-term investors in co-coordinating investment strategies for new sources of growth.

**Aidan Karibjanov**, Deputy Chairman of the Board of the National Welfare Fund Samruk-Kaz of Kazakhstan, discussed the context his fund operated within and its role in the country's development. High commodity prices have resulted in surpluses for the Kazakhstan government, which incorporates an assumption of $65 per barrel of oil. The fund is not a cash investor and instead is structured like an industrial holding company. It currently holds a portfolio of about 300 state owned companies. Along with its central goal of modernizing the Kazakhstan economy, the fund also focuses on improving corporate governance; the partial and full privatization of some of its portfolio of companies; and forging partnerships with international corporations.

**Adriaan Ryder**, Managing Director, Strategy, of the Queensland Investment Corporation (QIC) discussed the fund's structure and its approach to sustainable investing. The QIC was established in 1991 by the Queensland government (a resource rich Australian state) to prefund state liabilities, including pension and workmen's compensation. Mr. Ryder noted that there are probably no two QIC funds with the same investment objectives or time horizons.

On the issue of sustainability, Mr. Ryder discussed the issues around environmental, social, and governance investing (ESG). He identified three different investment strategies used by QIC:

1) Activist ownership, i.e. an activist approach to corporate governance. Due to the lack of internal experience, QIC, which owns $25-$30bn in the listed equity space, has outsourced a lot of the corporate governance around ESG to a company which specializes in the area.

2) Incorporating ESG considerations into the investment process. For QIC, this relates to direct investment in real estate, timber, and private equity. QIC has been much more activists in this area. They have directed managers, for instance, to "green" or retrofit buildings. They did not find that this was a big issue with the real estate managers, who recognized the benefits of energy efficiency.

3) Private equity investments. While they do not use specific parameters, they have directed managers to focus on sustainable investments such as waste management. They have not seen, however, an increase in such investments despite indicating interest. The experience of public-private partnerships (PPPs) also has been relatively poor. In particular, past greenfields developments have perhaps incorporated too many heroic assumptions. This may present a high hurdle for other Australian investors.

**Dr. Haizhou Huang**, Chief Strategist of the China International Capital Corporation, began by presenting an intergenerational-type rationale for the importance of long-term sustainable investing in the Chinese context. He argued that China is still in a demographic sweet spot. The ratio of net producers to consumers is

still positive, and is expected to persist for some time. Hence one might expect high savings rates to also persist for some time. The Chinese working age population will peak in 2015, but only in 2040 will net producers fall below net consumers.

An important aspect of long-term sustainable investment for China is security of food imports. Other aspects of sustainability which are important to develop include the need to find a risk-sharing mechanism; to identify assets to invest in over time and across regions; to secure diversification across currencies and countries; and to develop and promote international governance mechanisms. Fundamentally, he noted that countries must establish long-lived institutions to manage long-term investment needs. Examples of such institutions he discussed were university endowments, various foundations, family offices, and sovereign wealth funds.

**Dr. Luiz Eduardo Melin de Carvalho e Silva**, Executive Director of the Legal and Foreign Trade Division of Banco Nacional De Desenvolvimento Economico e Social (BNDES), began with an overview of the institution. He noted that BNDES is properly characterized as a development bank and is a 60-year-old government-owned institution. The main mission of BNDES is to promote economic and social development in the Brazilian economy and to fill gaps which exist in the Brazilian production chain. Of its $330bn assets under management, it disburses about $100bn a year in credits and guarantees. Sometimes it takes equity participation in Brazilian companies. Since the 1980s, social objectives, such as innovative programs around SMEs, have been incorporated. The desired return is 2 – 2.5 % on return on assets, and 20% return on equity. BNDES has large reporting responsibilities to the state, including the congress, and the attorney general, which has large powers of inspection.

There have been periods (for example in 2009) where BNDES was used by the government as a countercyclical tool through the provision of credit. This included unusual measures such as the provision of working capital. At present the Brazilian investment rate is "too low" at 19%, and the administration has an aim of increasing it to 23% of GDP at the end of this term. This implies gross investment of $2tn in the next three years, which will be primarily directed toward energy (oil and gas, distribution), productivity-enhancing infrastructure (ports and railway), and other building and construction (including housing). Elevated commodity prices also means an increased focus on agribusiness.

There has also been increased collaboration with international investors who feel more comfortable with BNDES. As a result, Brazilian capital markets have grown markedly. BNDES regularly interacts with SWFs in Brazil including Mubadala and Temasek. Infrastructure investments tend to require a domestic partner, to manage complicated domestic conditions. Infrastructure also incorporates some important exchange rate risks. In countries with an active industrial policy, such as Brazil over the last decade, investors need some convincing of the convergence between their investment objectives and those of the industrial policy. BNDES' experience suggests these are not insurmountable.

**Professor Jean Tirole**, Chairman, Board of Directors of the Toulouse School of Economics, reiterated the availability of premia through the provision of liquidity. He also suggested that investors should not simply exit. Long-term investors can earn premia through the exercise of voice, though this might be outsourced to dedicated agents (as indicated by the QIC experience).

In terms of what to invest in, Professor Tirole suggested that innovation is important, but one should first examine whether the conditions are available to develop those clusters. Not every region will be able to attract the PhD students who are likely to create startups. In addition, long-term investment in carbon might be successful, but banks might not be a great target.

He then turned to the issue of socially responsible investing (SRI). The rationale is both a market and, importantly, a regulatory failure. There are three concepts of SRI: 1) Doing good by doing well, which can include preventing short-termism by exercising voice; 2) Delegated philanthropy, the notion that shareholders demand good behavior; and 3) Corporate philanthropy, which is the only one of the three not necessarily consistent with profit-maximization.

**Questions**

A participant discussed some of the techniques available to incentivize for the long-term. These involve various private equity-type pay structures (end-of-period payouts and clawback mechanisms such as rolling averages). It was noted that they may become more difficult in the US with possible future tax changes directed at hedge fund managers who are taxed at the lower capital gains rate.

A participant asked about how to balance regional investing for development with profit-seeking. It was noted that inclusive mechanisms and transparency can build domestic legitimacy. In Brazil, regional mechanisms exist --- the cost of capital charge on a more profitable region is higher than in the north which is less developed.