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ESG and Private Market Assets: Pension and Insurance Investors Shifting the Trillions (2022 – 2026)

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Since the adoption of the **European Union** Green Deal 'Fit for 55' legal & regulatory package, and, less than four months later, the passage of the bipartisan Infrastructure Investment and Jobs Act, known as the **Biden Infrastructure Bill**, in the United States, the notion of infrastructure as an asset class has moved centre stage: from **Blackrock** to the **Bank of England**, the "case for institutional investment in infrastructure" is being made more forcefully than ever. Perhaps this means that after a relatively slow start (2005 – 2020), the notion of pension investment in infrastructure will finally be moving into the mainstream, as we shall argue here. This change in thinking is happening against a particular geoeconomic backdrop: the progressive realization by policy makers in Beijing, Brussels, London, and Washington DC that "pension powers" can play an essential role in building the ESG-driven world economy. [1] The severe Covid lockdowns and ensuing supply chain disruptions and social unrest (notably in 2020 – 2021 in the United States) have emboldened pension board members (representing civil society) and labor organisations, whose newfound vigour gave rise to the *ESG-driven* "build back better" policy agenda, both domestically, in the United States and other industrialised nations, and abroad, in the emerging markets of Asia, Africa and Latin America. [2]

ESG and Employee-Capitalism as Mutually Reinforcing Trends

The co-authors of the article, are amongst the original coiners of terms such as "infrastructure as an asset class" and "pension superpowers." [3] They also predicted, at the onset of the Covid Crisis, that a "historic realignment on the asset allocation front is happening precisely at the moment when ESG is moving centre stage: even in once staunchly neoliberal jurisdictions like **Texas**, **Alaska** or **Switzerland**, the smart money is betting on renewable energy, greentech, social bonds, women's empowerment, employee shareholding and board diversity: this is an irreversible trend towards [what we call] the Age of Fiduciary Capitalism." [4] This primer reflects their personal interpretation of the "crossroads where ESG, infrastructure investment and pension superpowers intersect", and why they believe this will constitute a key feature of the "Fifth Industrial Revolution".

Pension board members (trustees), many of whom are employee representatives and union leaders, are flexing their fiduciary muscles like never before. In many ways, they now *represent* the interplay between civil society and financial markets. And, as we move into 2022, the rise of private market assets (diversification, quest for yields, and inflation protection) and the mainstreaming of the **United Nations** Sustainable Development Goals (SDGs) amongst policy makers and pension board members (cultural-ideological change transforming legal-corporate norms) will form mutually reinforcing trends, converging ultimately to redefine the terms of free market economics[5]. Or, as Larry Fink put it in his recently published 2022 Letter to Shareholders: "Workers demanding more from their employers is an essential feature of effective capitalism [...] "We are committed to a future where every investor - even individual investors - can have the option to participate in the proxy voting process if they choose." [6] In the UK, similar ideas were championed by Baroness Altmann, **House of Lords**, and Janice Turner, Co-Chair, **Association of Member Nominated Trustees** (AMNT).

Infrastructure as an Asset Class for Pension Investors

Pioneers like Claude Lamoureux, inaugural president and chief executive officer of the **Ontario Teachers' Pension Plan** (OTPP), Christina Currier of the **Texas Department of Transportation** and Michael Nobrega, former President and CEO of the **Ontario Municipal Employees' Pension System** (OMERS), one of Canada's largest pension funds, started to use the term "infrastructure as an asset class" in the first decade of the century. The Hon. Nick Sherry led similar efforts in Canberra in his various parliamentary and ministerial roles – notably **Minister for Superannuation** & Corporate Law in the Labor Government of Kevin Rudd, and so did M. Nicolas Firzli in Paris and Brussels – AXA, French Society of Financial Analysts, **World Pensions Forum**.

Pension pioneers pictured here LtR:

Claude Lamoureux, inaugural president, Ontario Teachers' Pension Plan (OTPP)

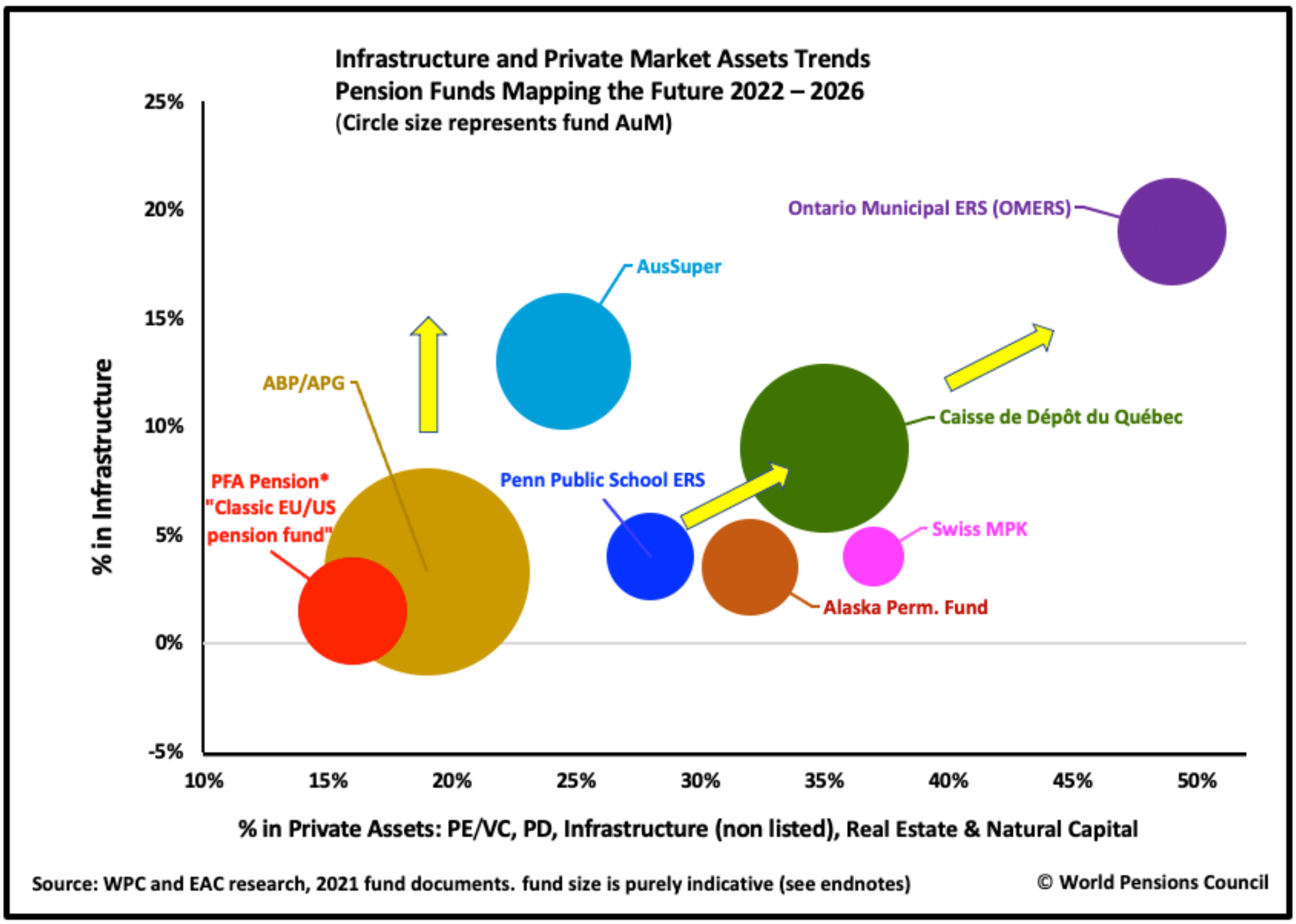
The Hon. Nicholas Sherry, former pension minister of Australia, Chairman, EU ASEAN Centre

Michael Nobrega, fmr. CEO, Ontario Municipal Employees' Pension System (OMERS)

A look at the policy planks and economic programmes of practically all **G20** nations for the next four to eight years, including the **EU 2030 Climate & Energy Framework**, Korea's New Deal 2.0, **Saudi Arabia Vision 2030**, indicates that many governments intend to draw on increased private investment in "green and modern infrastructure" to leverage government funds at federal, state (provincial) and municipal level: inviting foreign asset owners to '**Choose France**' (Emmanuel Macron), relying on the perceived economic patriotism of national pension and insurance giants (Boris Johnson), or a combination of both strategies (Justin Trudeau and Scott Morrison). How reasonable are these policy expectations? Can we expect pension investors to increase substantially their allocation to infrastructure assets?

We believe institutional asset owners will step up to the plate in the coming quarters, especially large funds from six key pension superpowers, whose combined assets represent more than 75% of the world's total: the **United States**, **Canada**, **Australia**, **Japan**, **Holland** and the **United Kingdom**. The 'Canadian model' favours straight investment in infrastructure assets/projects (direct ownership), whereas the 'Australian model' relied, until recently, on the indirect route, favouring limited partnership (LP) arrangements with specialized asset managers (investing in funds). The recent wave of mega-mergers across the Australian superannuation ecosystem means that, increasingly, Australian pension funds have the suitable size and scale to follow both routes if they so wish, depending on sub-asset typology and geography: "the wall of capital pointed at Australia is just enormous, it's seen [by both foreign and domestic pension investors] as a mainstay, a very safe jurisdiction for infrastructure investing".[7] Here, we can also learn from Canada and Australia's brand of ESG pragmatism: avoiding rigid one-size-fits-all 'exclusion lists', and understanding that the path to net zero may, perhaps, require continued investments in nickel, uranium and rare metals extraction, as well as natural gas and LNG infrastructure as we transition to greener ways and means.[8]

Large institutional asset owners could double their allocation to private market assets in the next four years, shifting hundreds of billions of dollars annually towards infrastructure assets domestically, accelerating the investment flows coming into the **United States**, the **United Kingdom**, and the **European Union**, and also into emerging markets, including Association of **Southeast Asian Nations** (ASEAN) member states. Many of these investment flows will come from cash-rich pension and sovereign wealth investors in **Canada**, Singapore, the Arabian Gulf/**CCAS** and **Australia**. We believe private market assets under management (PM-AuM) should grow by up to 20% per annum in the coming years (2022 – 2026), more than double the current rate.



The investment potential of large institutional asset owners, such as public pensions and sovereign wealth funds, can be visualised through the Infrastructure & Private Markets Investment Matrix, an original strategic assessment tool developed by Nicolas Firzli, **G7 Pensions Forum & ESG Summit**, and Dr. Joshua Franzel, MissionSquare Research Institute (MSRI), International **City/County Management Association** (see chart).[9] The yellow arrows show the likely asset allocation evolution for the next four years, with a marked increase in the allocation to **infrastructure** (**Y axis**) and, also, private assets across the board: infra, **private equity**, venture capital, private debt, real estate, and **natural capital** like **forestry and farmlands** (**X axis**), moving towards the "Australian allocation" (5% to 12% of overall assets in infrastructure), exemplified by **AustralianSuper**, or, for the largest players, the "Canadian model" (8% to 20% in infra, often in direct ownership, see graph).

Our chart shows notably the **Ontario Municipal Employees' Retirement** System (OMERS) and the **Caisse de Dépôt et Placement** du Québec, two archetypal Canadian pension investors: "by investing early on in non-listed assets (private equity, real estate, infrastructure, forestry, and commodities) both domestically and abroad, Canadian public pension and sovereign funds have attracted attention on both sides of the Atlantic: 'They own assets all over the world, including property in **New York City**, utilities in **Chile**, international airports, and the high-speed railway in the **United Kingdom** [...] They have won the attention both of Wall Street firms, which consider them rivals, and institutional investors, which aspire to be like them'."[10]

Denmark's **PFA Pension** (red circle) represents the "typical EU or US pension fund", with 15% to 18% in private assets, including roughly 1.5% in non-listed infrastructure, a very common allocation across many **OECD** countries – it's the allocation mix of **CalPERS**, the US's biggest pension fund. The two northeast arrows indicate the direction likely to be followed by most pension investors in the next four years: raising their allocations to infrastructure and other private assets such as private equity and real estate *in similar proportions.* In Mainland Europe, sophisticated institutional investors such as **Holland**'s **APG Asset Management**, which manages investments on behalf of several Dutch pension funds, chief among them **Stichting Pensioenfonds ABP**, already have an ambitious asset allocation, with more than 3% in non-listed infrastructure and nearly 20% in private markets overall (see chart).

ESG and effective capitalism pictured here LtR:

Andrew J. Bailey, Governor, Bank of England

Larry Fink, Chairman and CEO, BlackRock

Baroness Ros Altmann, UK House of Lords

The Fifth Industrial Revolution Has Begun . . .

Australia and Canada are examples of global leadership in infrastructure investment. Both are middle ranking economic powers with stable legal-political systems (English common law, with the partial exception of **Quebec**), large pension industries – the world's 4th and 5th largest by assets – and well managed funds with significant investment in private market assets, both domestically and internationally. They invest massively in ports, airports, rail and urban transport networks, energy, and social infrastructure, including hospitals and student housing. Another shared feature is the growing governance role played by pension trustees, including employee representatives ("fiduciary capitalism").

Not coincidentally, both countries are at the forefront of investment in renewable energy and cleantech, digital infrastructure, artificial intelligence, and biotechnology: the foundational sectors of the **Fifth Industrial Revolution**. Now, in other countries, some of these sectors and industries can still be perceived as excessively "illiquid" or "too risky" for pension investors: criticisms sometimes laid at the door of infrastructure and tech assets generally by conservative lawmakers and financial regulators. We understand their anxieties, but we believe those risks can be surmounted with five simple policy recipes:

1. Ensuring the sovereignty of (public) pension boards when it comes to allocation decisions. Investment committees must always remain at arm's length from the government.

2. Guaranteeing the sanctity of property rights and contract law (safeguarding privatised assets and public private partnerships notwithstanding changes in government), with truly independent judiciary branches.

3. Adopting a pragmatic, centrist approach to energy transition and asset classification: recognising that "natural gas and nuclear energy could [in some cases] make a contribution in the difficult transition to climate neutrality" (**European Union Taxonomy** for Sustainable Activities).

4. Being willing to commit to truly long-term privatisation and concession programmes (e.g., ports and airports in the US, Latin America, and the EU, where governments need to secure a sufficient number of assets in their privatisation pipelines).

5. Perhaps more importantly, adjusting macro-prudential regulation to allow pension and insurance investors – and the investment banks that lend them money – to allocate substantially more to 'illiquid' assets without being handicapped by overzealous financial regulators. As we write these lines, the UK government and the **Bank of England** have indicated they will soon be reforming **Solvency II** rules adopted when the UK was in the EU, thus making it easier for large asset owners such as insurance companies to invest in infrastructure at home and abroad. The **National Treasury** (**South Africa**) also announced similar reforms.

As we move to a world of durably higher interest rates and greater focus on government debt, policymakers will need to rely more than ever on pension, SWF, and insurance capital. Hopefully, this will make the above policy measures more likely to be adopted.

The May 2022 issue of our *Future of Finance Series* will focus more specifically on US, EU, UK, and ASEAN insurance companies: understanding regulatory change and asset allocation dynamics etc.

***The Hon. Nicholas John Sherry** is the former pension minister of Australia (Minister for Superannuation) and one of the fathers of the 'Australian pension miracle'. Nick Sherry is the cofounder of the EU ASEAN Centre (EAC), Singapore Economic Forum (SEF), which he chairs, and chairman of the board of Household Capital, a leading Australian fintech providing home equity retirement funding and longevity income. He was educated at the University of Tasmania (BA Classics & Political Science) and is a fellow of the Australian Institute of Superannuation Trustees (AIST) and a graduate of the Australian Institute of Company Directors (AICD).*

***M. Nicolas J. Firzli** is the director the World Pensions Council (WPC), a global think-tank and asset owners association. Mr. Firzli is co-chair of the World Pensions Forum (WPF) held annually in a G7/EU capital and coordinator of the G7 Pensions Roundtable held on the sidelines of the G7 Summit. He is a graduate of Canada's McGill University (Statistics & Economics), an alumnus of the HEC School of Management (MBA) and the University of Paris Law School (LL.M.).*

***Dr. Guan Seng Khoo** is a Singaporean Canadian authority in the fields of public pension/SWF investment (PPSI), governance, risk management & compliance (GRC) and enterprise risk management (ERM), currently serving as Vice-Chair of the Advisory Council, EU ASEAN Centre (EAC), Singapore Economic Forum (SEF). An alumnus of hedge fund giant Man Group, where he was the Principal Scientist, pioneering the use of advanced algorithmic Ai-based investment frameworks, he also held senior managerial positions at Singapore's Temasek Holdings and the Alberta Investment Management Corporation (AiMCo), two of the world's leading sovereign wealth investment institutions. He also serves on the board of directors of several deep-tech IT & Ai companies in China, the ASEAN area, the US, and Canada. Dr. Khoo holds a PhD in Computational Physics from the National University of Singapore (NUS).*

ENDNOTES & RESOURCES

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[9] All data visualised here are based on World Pensions Council (WPC) and EU ASEAN Centre (EAC) proprietary research reflecting notably (but not exclusively) annual reports and quarterly investment updates as of Q3 2021 for a selected sample of significant pension investors, fund AuM (bubble size) being purely indicative. The first version of the Infrastructure and Private Markets Investment Matrix (2014) was designed jointly by Nicolas Firzli, WPC, and Dr. Joshua Franzel, MissionSquare Research Institute (MSRI)

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