SWFs and other Long-Term Investors Conference:

FROM SAVINGS GLUT TO SUSTAINABLE GROWTH

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Obstacles to the Global Deployment of Investment

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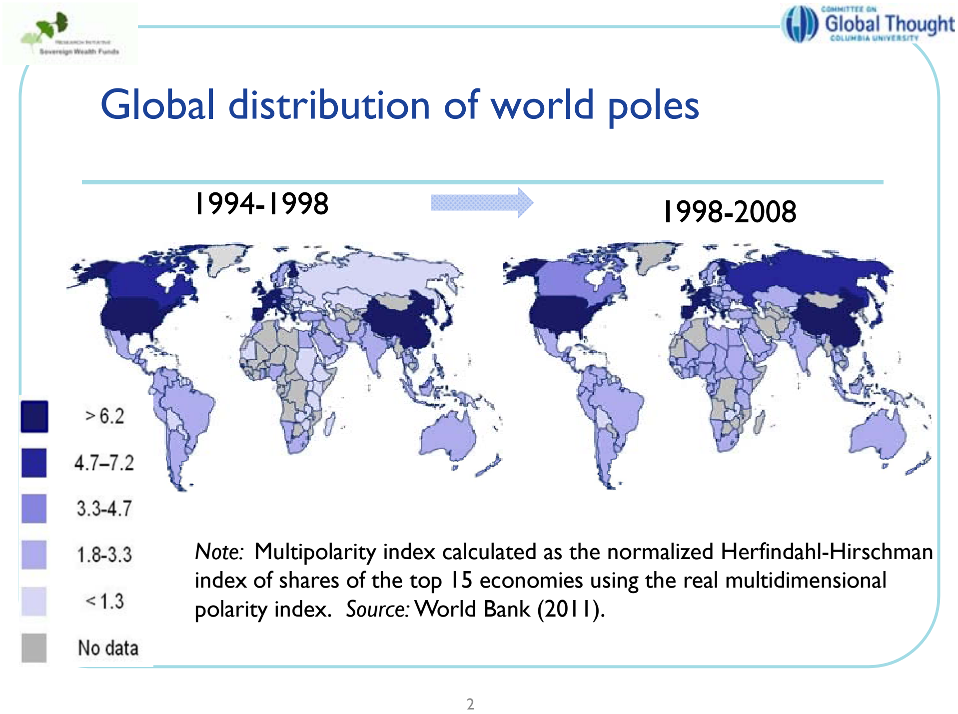
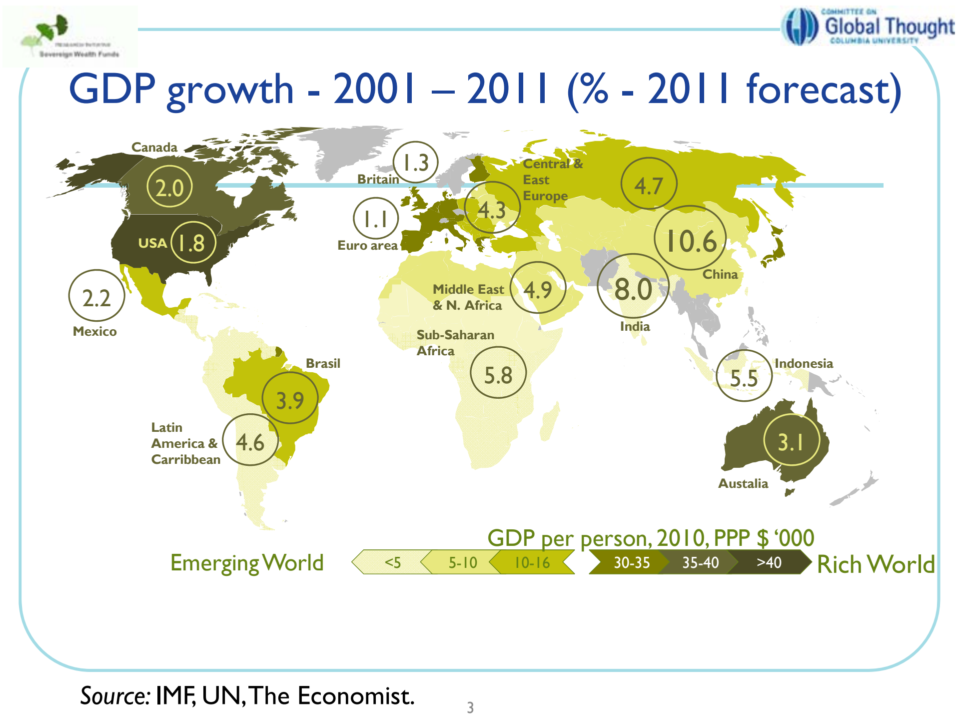
As you all know, great transformations are expected in the future of world economy. The speed of globalization has suddenly increased; it will increase even further in the next decades. It has been based on some key factors: (i) a geopolitical factor, with the fall of the BerlinWall, and the shifting of the political power from the Atlantic to the Pacific;(ii) a technological factor, given the spreading use of IT and the lowering oftransportation costs; (iii) an economic factor, with emerging economies producing low-costgoods and advanced economies buying them partly on credit; (iv) a financial factor, via thecreation of global virtual money; and finally (v) an ideological factor, the“political apotheosis” of free market economy.

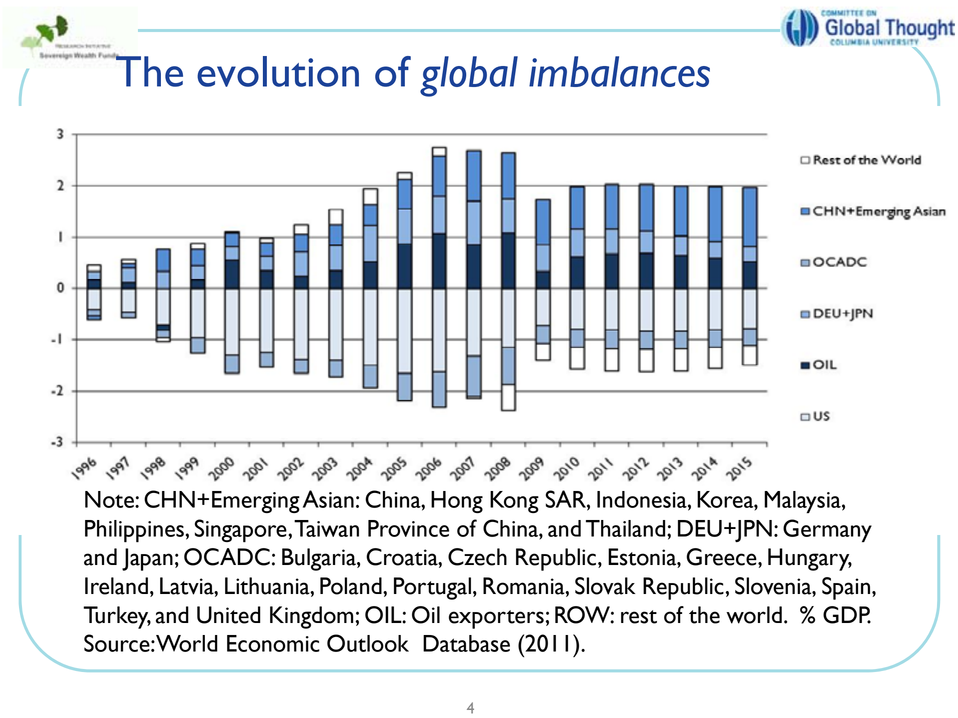
[1] This Speech has been written in collaboration with Edoardo Reviglio, Chief Economist of CDP. The Author wish to thank Davide Ciferri, Gino del Bufalo, Gianfranco di Vaio and Annachiara Palazzo, of the CDP Research Department, for the assistance in the collection and elaboration of the statistical data contained in the paper.



By 2025 countries such as Brazil, China, India, Indonesia, Southern Korea and the Russian Federation will become major contributors to global growth, alongside the advanced economies.

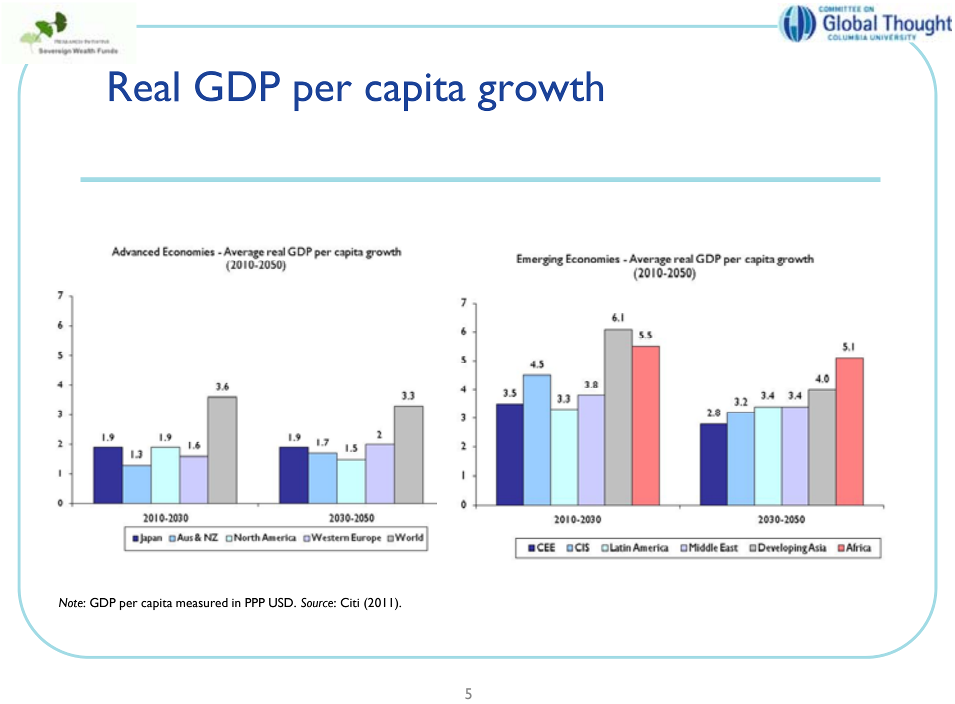


Corporations based in emerging markets are playing an increasing role in global business and cross border investments. SWFs and other pools of capital are increasingly important sources of international investment and they are becoming major players in financial markets. Global imbalances will take new forms.



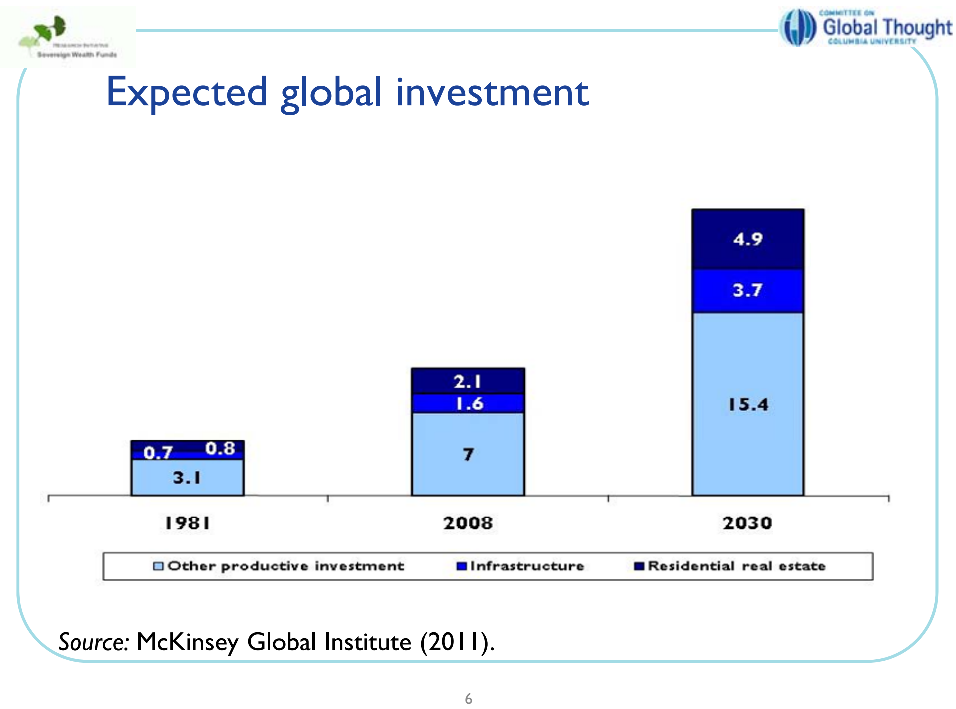
If properly directed, they may move capitals where they are mostly needed, contributing to a more stable global growth. However, they may also become sources of conflicts. The international monetary system will move from a single currency to a multiple currency system. A new world order is emerging; multi polarity is the “new name of the game”.

Our thinking of the structural changes in the global economic landscape, however, can generally still be mapped into an asymmetric plane. On the one hand we have the advanced world with high public and private debts, old population and low growth rates.

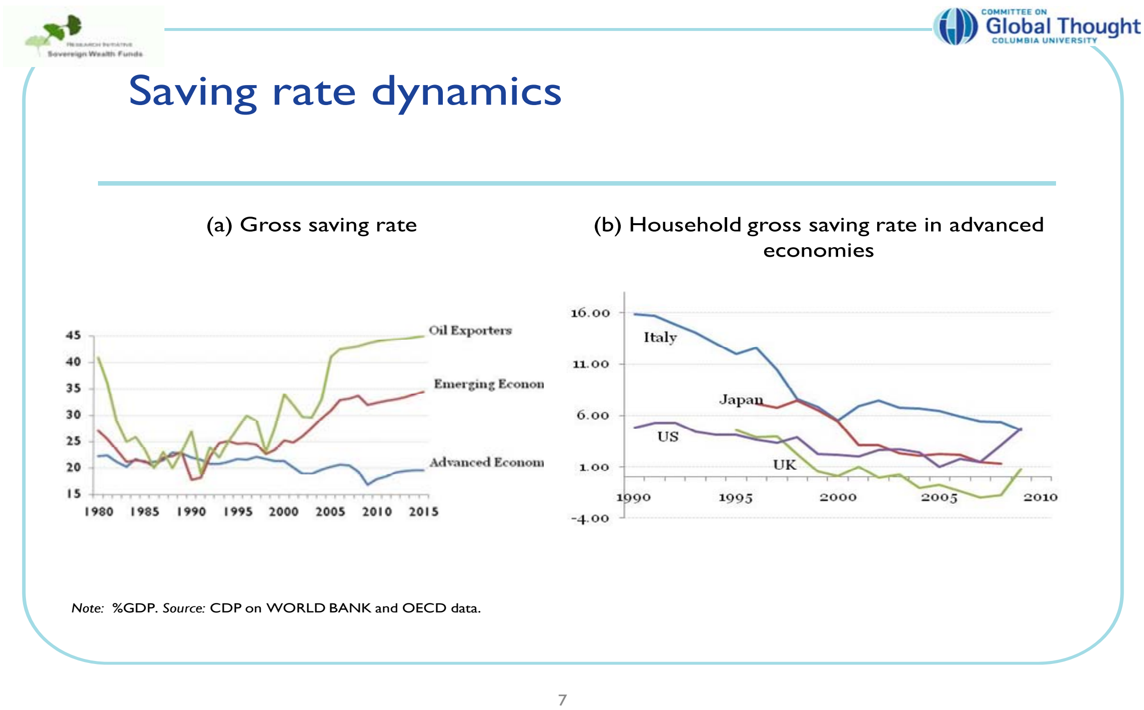


On the other hand we have the emerging world with low public and private debt, young population and vibrant growth rates. The IMF forecasts that emerging economies by 2013 will produce more than half of global output.

In the next decades, we expect a huge increase of demand for capital investment.



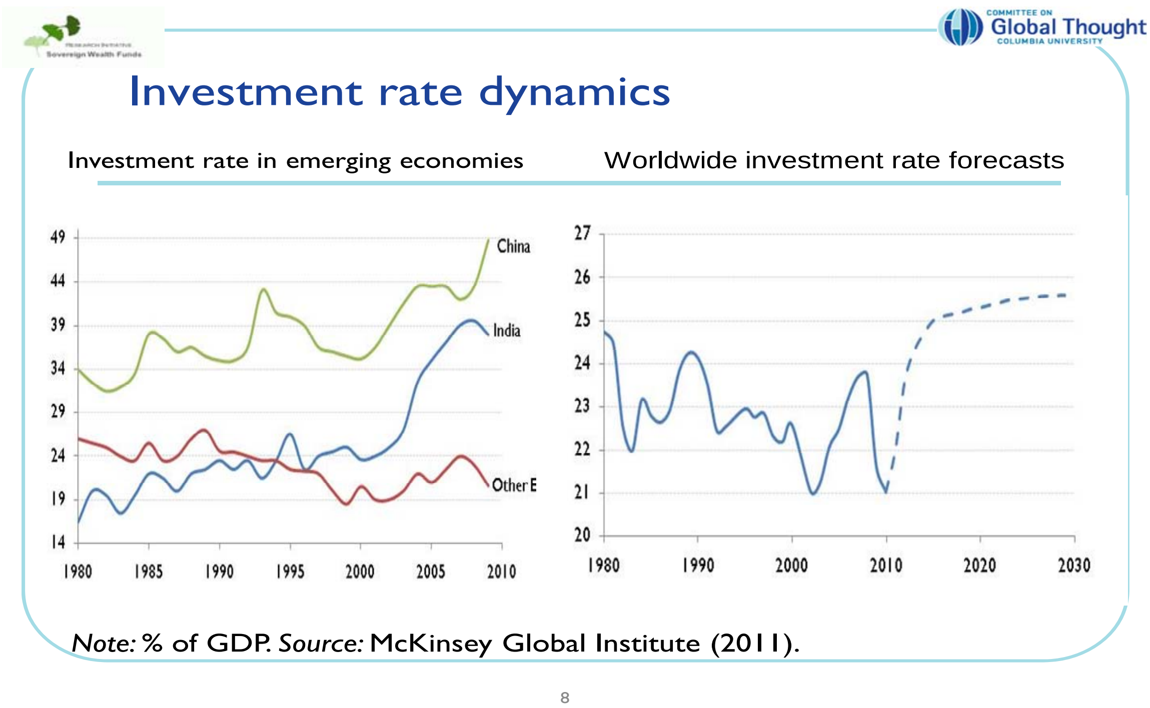
In mature countries, there is a pressing need to finance infrastructure, innovation, environmental programs, as well as to prepare for the consequences of an ageing population. In developing countries, the income per capita catching up process is requiring vast investments in infrastructure (transportation, TLC, energy, urbanization)[2]. Mature economies will also need to increase their share of long-term investment to exit the crisis, to reinforce their growth rates and competitiveness on global markets and to ensure public debt sustainability (successful fiscal long-term consolidation requires both stricter fiscal policy and more economic growth). Emerging countries with high saving rates will be increasing their domestic demand.



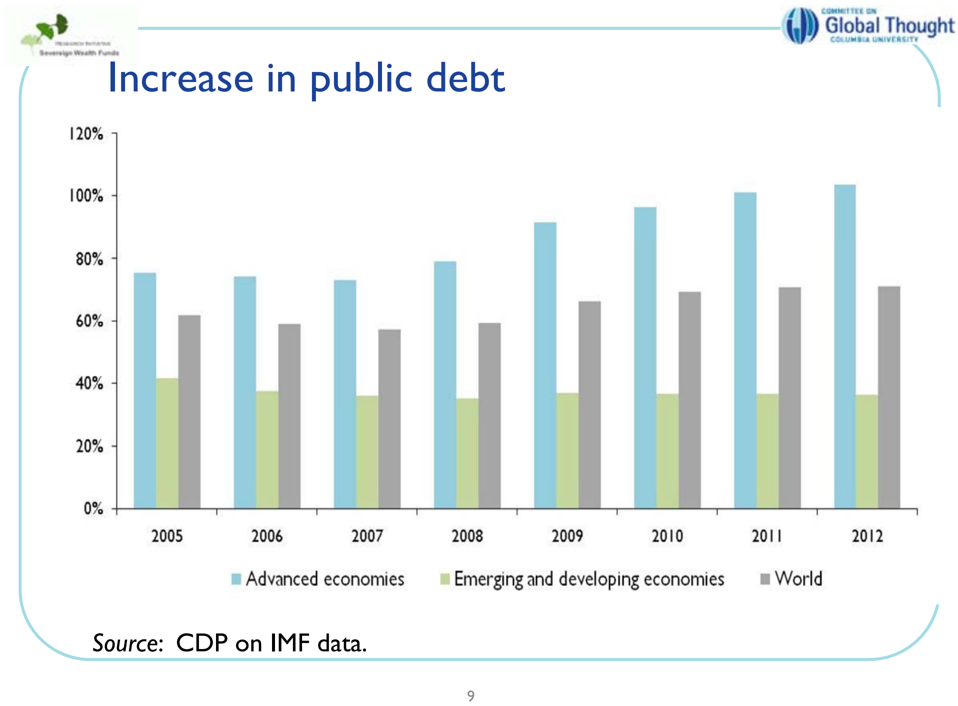
Given the focus on short-term finance prevailing in the last decades and, thus, the scarcity of long term finance, the competition for capital will be intense. The coming investment boom will put sustained upward

2 In India, the Eleventh Five Year Plan (2007-2012) increased the resources for investment in infrastructure: from 5.1% (of the Tenth Plan) to 7.6% of GDP (over $ 500 billion). In the Twelfth Plan the government plans to spend resources for investment in infrastructures up to 9-10% of GDP.

pressure on real interest rates unless global saving increases significantly. In advanced countries saving is not increasing enough, leaving a substantial gap between the willingness to save and the need to invest. This difference between the demand for capital to invest and the supply of saving will likely increase real long-term interest rates.



The gap between investment and saving is the main cause of the well known "global saving glut" (Bernanke, 2005). In the global scenario outlined above, the rise in investment rate at global level will rebalance the excess of liquidity in the capital markets. As a result, we may experience the end of the "saving glut". But what is most worrisome for the West is the fiscal position and the surge of public debts.

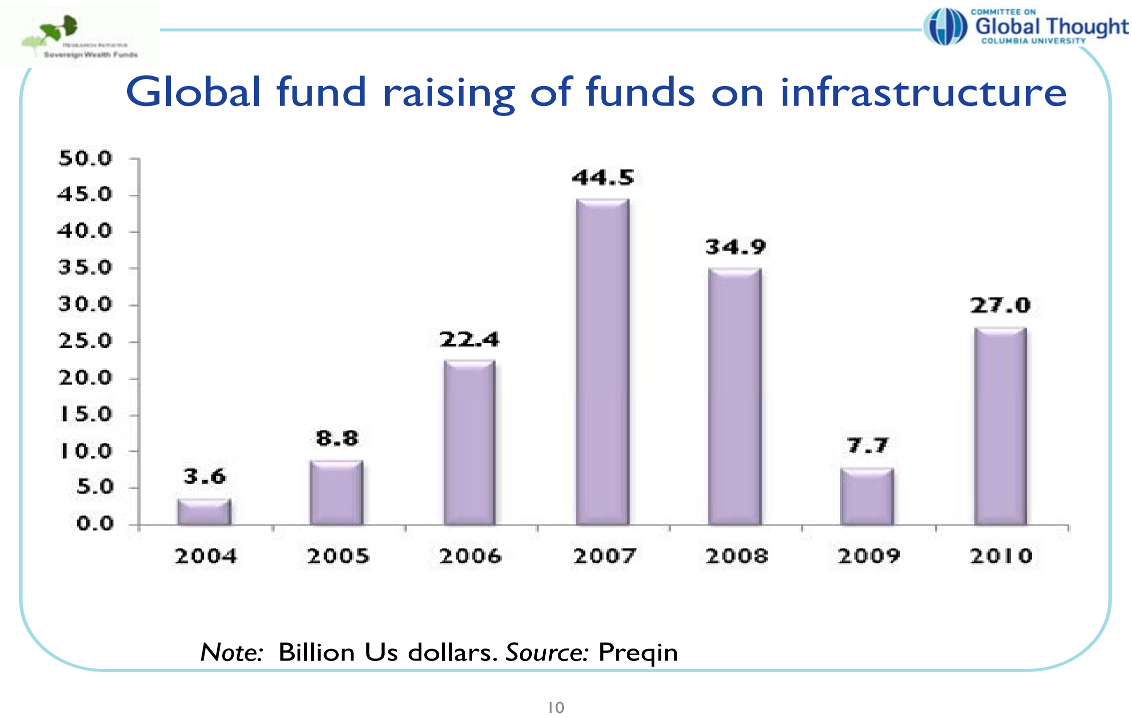


Since the burst of the crisis the increase in public debt in advanced countries was huge: from 73% of GDP in 2007 to 94% in 2009; it is expected to increase even more in the next years, so as to reach a peak of 108% of GDP in 2013. The opposite is true for emerging economies. During the crisis period, the public debt remained more or less constant on a value of about 35% of GDP and is predicted go back to a pre-crisis level of 33% of GDP by 2013.

The advanced world will be more and more dependent on the inflows of capital from the rest of the world to finance its public debts and its investment needs. Such dependency may have negative effects on its sovereignty. Who owns "part of our debt" – in fact – owns also "part of our choices": when the level of debt goes over a sustainable threshold, creditors become our masters. The asymmetric fiscal position between the West and the rest of the world will then have long lasting effects on the world economy changing balance of power.

On the positive side, the West may take advantage of the inflows of capital from the surplus countries to finance its long term needs for infrastructure, in the building and management of high-tech strategic assets, and in financing its high public debt. The question is how to make attractive the project financing initiatives - "structured" as a financial "asset class" – for global long term investors.

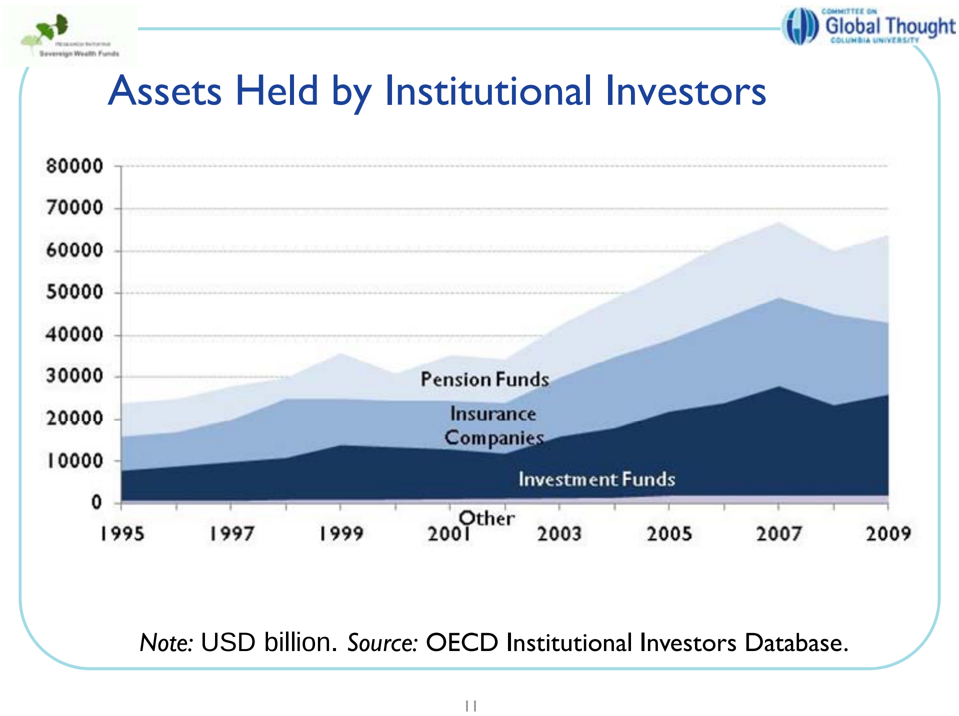
Is there a sufficient potential appetite for private equity for infrastructure and for infrastructure bonds producing long term "revenues streams" (up to 35-40 years) in the portfolios of global investors?

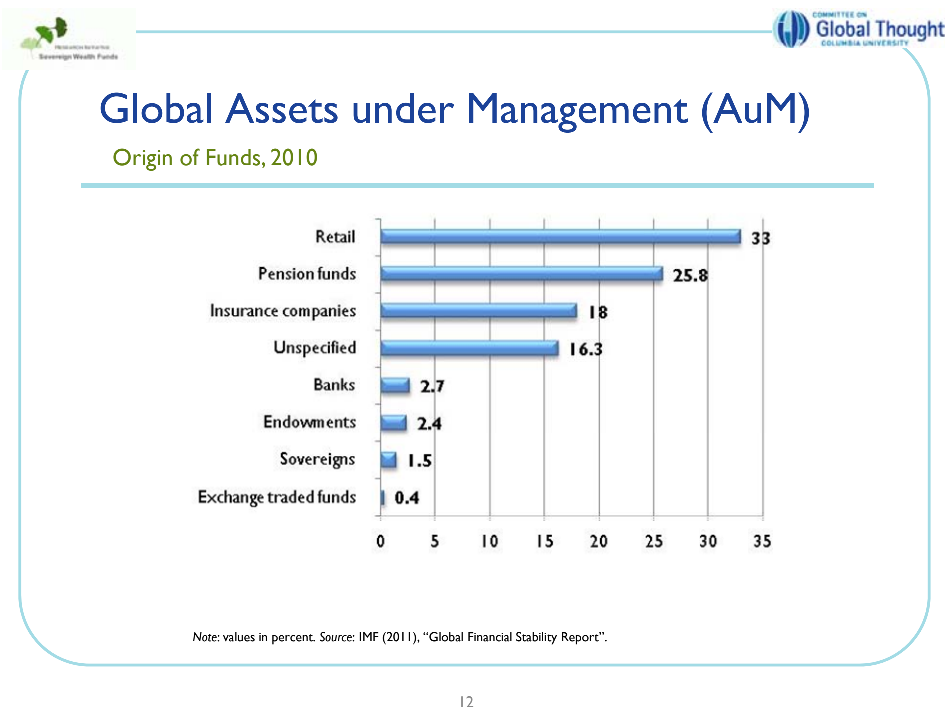


Long term investors and their asset allocation

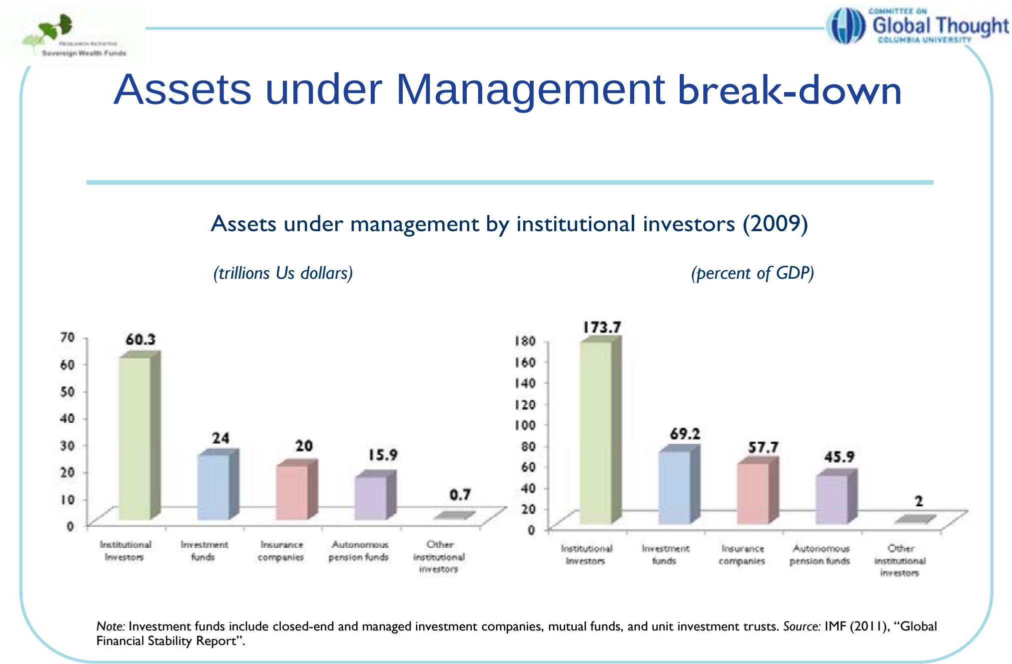
The asset allocation decisions of investors are the core of financial flows between markets, currencies, and countries.

Long term institutional investors of 17 OECD countries at the end of 2009 held 60 trillion US dollars of total assets, compared with 72 trillion in total bank assets (IMF, 2011).





A large part of the assets are held by pension funds (26%), life insurance (18%), endowment funds (2,5%) and SWFs (1,5%) (IMF, 2011). The asset allocation differ widely by country and by type of investor, depending on their specific objectives.



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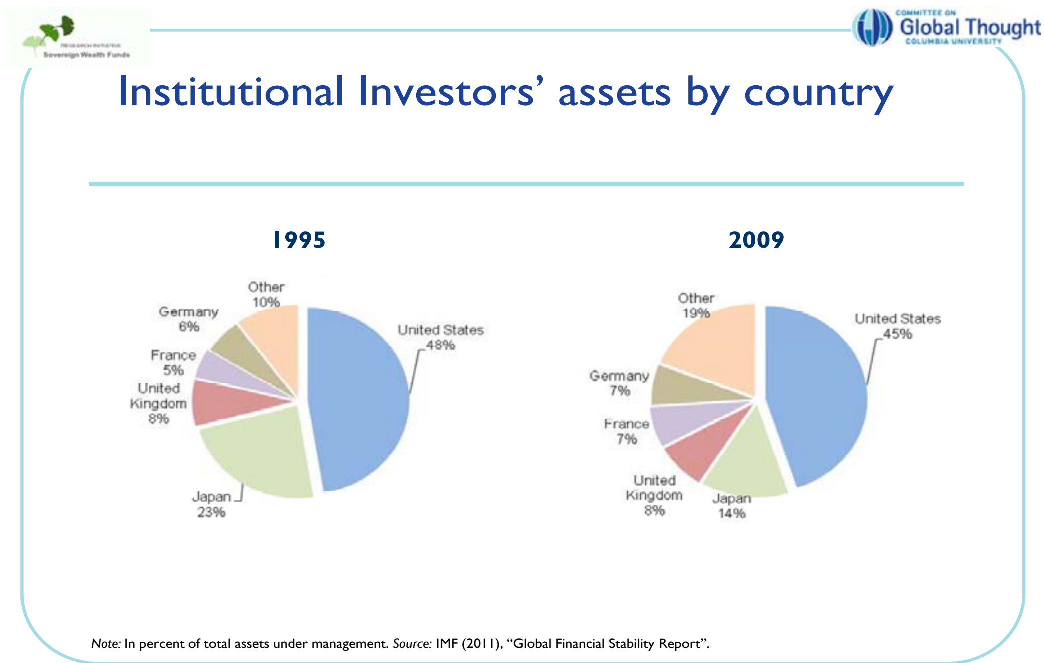

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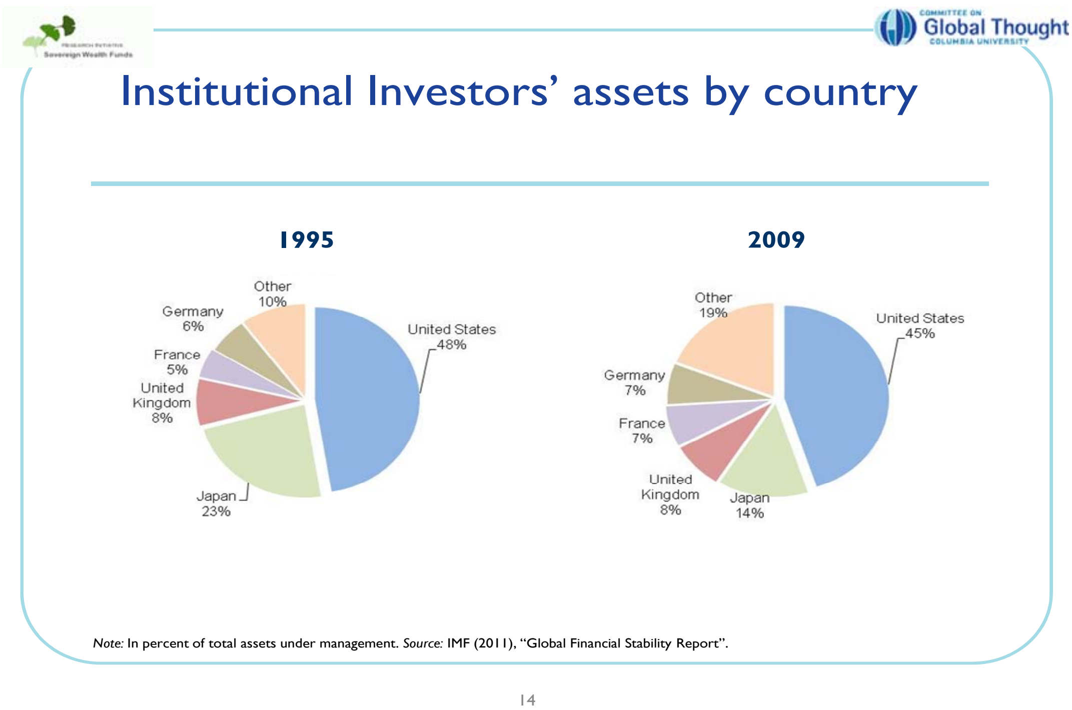
Private asset managers play a key role in global asset allocation. The real-money managers (as distinct from managers of leveraged money, such as hedge funds and carry traders) include private wealth managers, mutual fund managers, and pension fund managers.While mutual funds are mainly short-term investors driven by an opportunistic investment approach (reflecting investor and asset managers appetite), pension funds, insurance companies, endowment funds and SWFs are typically investing over a much longer investment horizon.

An increasing share of these assets could be available for potential investment in less liquid and longer term risk assets.



To date, taken together, investment tranches are still small, and government bonds remain the dominant asset class. In the next future, however, long term financial instruments to finance infrastructure and smart energy system may (and should) attract flows of capital worldwide contributing to change the asset allocation strategies of private and official institutional investors with great advantage for the recipient countries.

Obstacles to the Global Deployment of Investment

From a recent IMF Survey on Global Asset Allocation (2011) macroeconomic condition of the recipient country is the principal element of decision. The World Bank and the Unctadplace also considerable emphasis on political stability and outlook as well as on the quality of regulation; the main rating agencies consider these to be main elements in decision making about investment abroad.Asset allocation of long term investors is driven most strongly by positive growth prospects and falling risk in the recipient countries; interest rate differentials play lesser role.

However, microeconomic factors are also very important in global asset allocation: on the demand side, the microeconomics of the asset management industry; and on the supply side, the type and quality of the long term financial instruments offered to investors.

On the microeconomics of the demand side, accounting and regulatory frameworks play a crucial role in asset allocation. The overall regulatory setting (including its most recent updates) is still providing unfavorable incentives to long term investment.In particular, accounting rules that are appropriate for investment banks and trading activities are sometimes penalizing for long term investors. The new Basel III capital requirements and liquidity will probably discourage long term financial initiatives. Moreover, the IASB mark-to-market philosophy is particularly damaging for long term investment, attributing instant market values to assets the value of which is by essence based on several years; and the Solvency II Directive in Europe, as recently recognized also by the IMF, will discourage insurance companies and pension funds from holding infrastructural assets, not allowing for a proper matching of long term liabilities and assets on their balance sheets.

The need for a new regulatory framework, more favorable to long term investment, meets today a broad worldwide consensus in the scientific community, among the practitioners, the industry and the policy makers. At the EU political level it has been strongly emphasized by the European Commission – following the de Larosière and Monti reports - in the communications on the *New Single Market Act*, on the *European Investment Policy* and on the *Budget Review*. Nevertheless, no concrete policy initiative has been launched to correct the pro-cyclical and pro-short-term effects of the current regulatory framework.

On the microeconomics of the supply side, it is important that solid and well-structured long term financial products are offered to long term investment. In general, we may distinguish between two general types of products for financing infrastructure: equity and bonds.

Equity products are mostly in the hands of private equity funds specialized in infrastructure, while the institutional demand for equity for infrastructure traditionally does cover only a (minor) part of total demand. However, recent market sources have registered a growing appetite for equity for infrastructure.

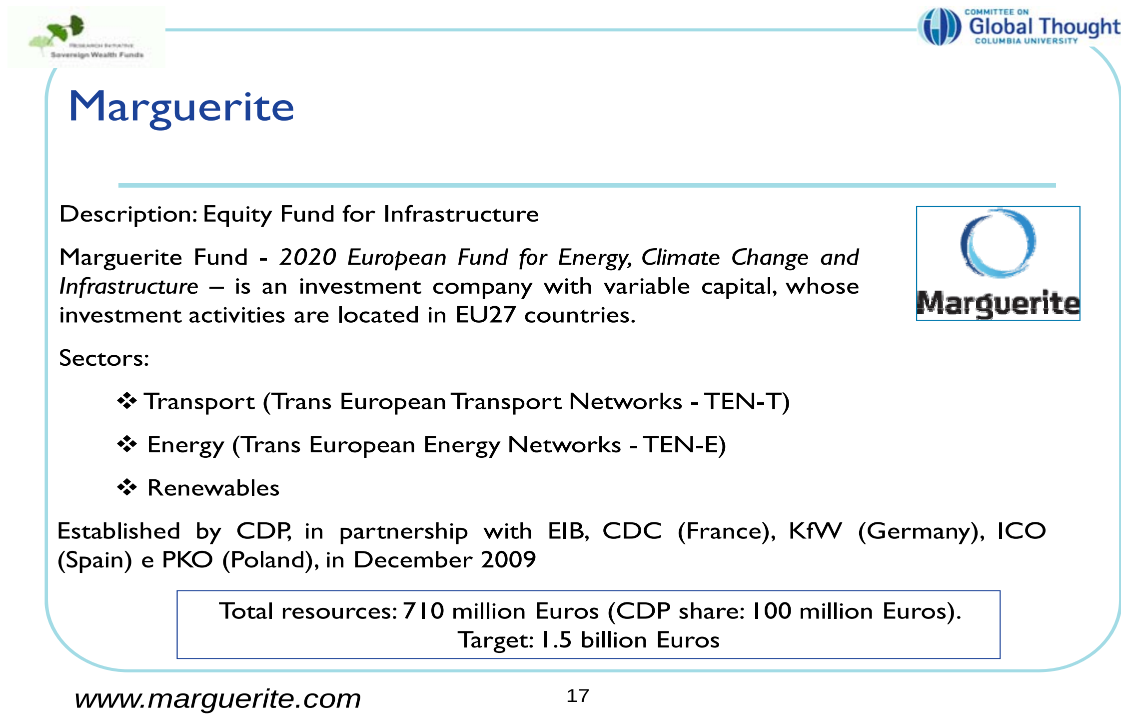
Interest in European Infrastructure – SWFs and Pension Funds

SWF	Country	AUM ($bn)	Fund Overview / Strategic Rationale
ADIA جهاز أبوظبي للاستثمار Abu Dhabi Investment Authority	Abu Dhabi	$627	• Established in 1976, ADIA is responsible for investing Abu Dhabi's surplus funds in international markets; has an interest in European infrastructure (invests through ADIA Infrastructure) – Acquired a 24.1% stake in Gassled (an energy infrastructure company) with an investor consortium – Acquired a 15% stake in Gatwick Airport for $196mm
中国投资有限责任公司 CHINA INVESTMENT CORPORATION	China	$410	• Established in 2007, CIC has a diversified sector appetite, though has primarily focused on commodities, financials and real estate • Has previously invested in Europe and has indicated interest in the infrastructure sector
NPS National Pension Service	Korea	$314	• Established in 1986 to provide pension benefits in South Korea; NPS is the world's fourth largest pension fund • Has targeted overseas alternatives (infrastructure and real estate) to account for 40% of total foreign investments in 2011 • In early 2010, announced that it would take a 12% equity stake in Gatwick Airport for approximately £100mm
Kuwait Investment Authority	Kuwait	$296	• World's oldest SWF, KIA is globally focused across multiple sectors • Has previously invested in Europe, albeit has not disclosed any known direct infrastructure investments
GIC	Singapore	$248	• Established in 1981 to invest Singapore's foreign exchange reserves in long term and high-yielding assets • Has significant exposure to European infrastructure, including the following investments: Kelda Group ($2.1bn), Sintonia ($1.5bn), Budapest Airport, BAA (~$3bn) and Associated British Ports ($1.7bn)
TEMASEK HOLDINGS	Singapore	$157	• Established in 1974 to initially assume ownership of direct stakes held by the Government of Singapore in a variety of local companies; subsequently diversified into other global investments • Has previously invested in infrastructure, however, most infrastructure investments are not in Europe
Employees Provident Fund	Malaysia	$118	• Malaysian social security institution which provides retirement benefits for members • Currently, ~5% of the funds are invested outside Malaysia, though the EPF has stated its intention to increase this to approximately 10%; has indicated interest in Europe and in infrastructure
QIA جهاز قطر للاستثمار Qatar Investment Authority	Qatar	$85	• Established in 2005 to strengthen the economy of Qatar by diversifying away from the country's main source of revenue (oil & gas) • Has significant investment and interest in Europe; indirect exposure to European infrastructure through its $532mm investment in Hochtief, Germany's largest diversified construction company • Invested ~€2bn in Spain's Iberdrola (capital increase and strategic pact)

Source: SWFI, Fund websites, Factiva and Citi estimates

Today large institutional investment pools allocate up to 2% of their total portfolio in equity for infrastructure, according to recent market sources, but they may increase their share up to 5%, especially from investors in emerging economies, such as China, Korea, Singapore, Malaysia, and the Gulf countries.

A special type of fund, which I would like to mention briefly, has been launched by a group of European large development banks together with the European Commission.



It is a long term equity fund for infrastructure and energy, with the following characteristics:

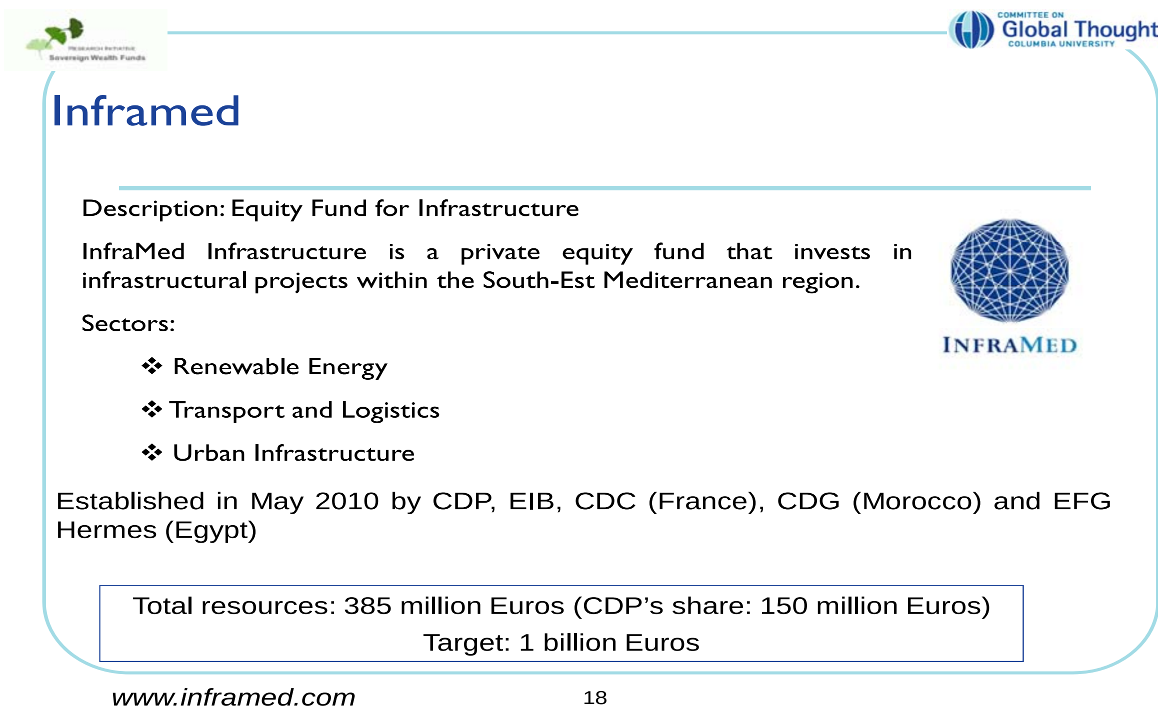
(1) a duration normally longer than the market operators are willing to take;

(2) non speculative IRR;

(3) a general "policy oriented" philosophy. Although "market conform", this type of "institutional" fund plays a "complementary" and not a "competitive" role in respect to the market.

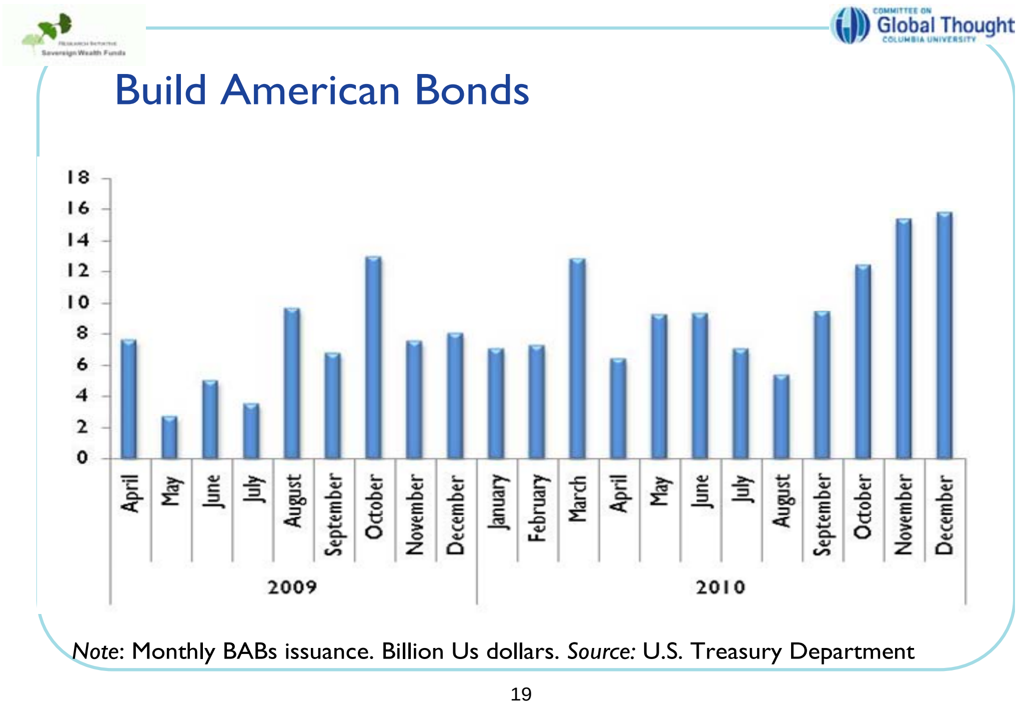
It is designed in order to support market funds, by taking longer positions and by lowering the overall cost of capital.

The two funds which have been launched based on this model - and which are successfully starting their operations - are the "Marguerite Fund" for the EU area and the "InfraMed Fund" for the MENA area.



On the debt side of the project financing initiatives, after the crisis of the monoclines insurance in the early 2007, special "project bonds" may become an alternative. The idea is to create new large bond markets for financing infrastructure, an attractive "asset class" for long term investment. Infrastructure bonds may find their proper allocation in the large asset pools, placed between government and corporate bonds.

In the USA a new market of project bonds name the “Build America Bonds” (BABs) has been created under the Obama Stimulus Plan.



From the time of the program's inception in April 2009, through the end of the program at the end of 2010, there were 2,275 separate BABs issues for over $181 billion of total, covering mass transit, schools, sewer systems, parks, municipal buildings, town halls, universities and hospitals. BABs have been used by small issuers, to finance construction of local schools, firehouses, and community centers. At the same time, BABs have been used by large issuers, to finance major infrastructure initiatives and capital projects.

The bonds have appealed to a broader set of investors, including pension funds and sovereign wealth funds controlled by foreign governments, and the wider demand has probably helped drive down interest rates for the bonds. According to market sources (CITI, 2011) global investors participated as investors up to 35% of larger projects and up to 15% of smaller projects. The bond program began when the municipal bond market was still reeling from the aftershocks of the credit crisis, and it gave states and municipalities another avenue for borrowing.

The bonds are issued directly by the project companies which enjoy a Government tax rebate of 35% on the interests paid on the bonds. The program was a success, mostly based on the existence of large pipeline of projects and by the high quality of the issuers companies.

A similar initiative (named the “Project Bond Initiative”) will be launched by the Commission together with the European Investment Bank (EIB) in order to build on existing experience with joint EU-EIB instruments and EIB's track record in EU infrastructure financing.The principal idea behind is to provide EU support to project companies issuing bonds to finance large-scale infrastructure projects.

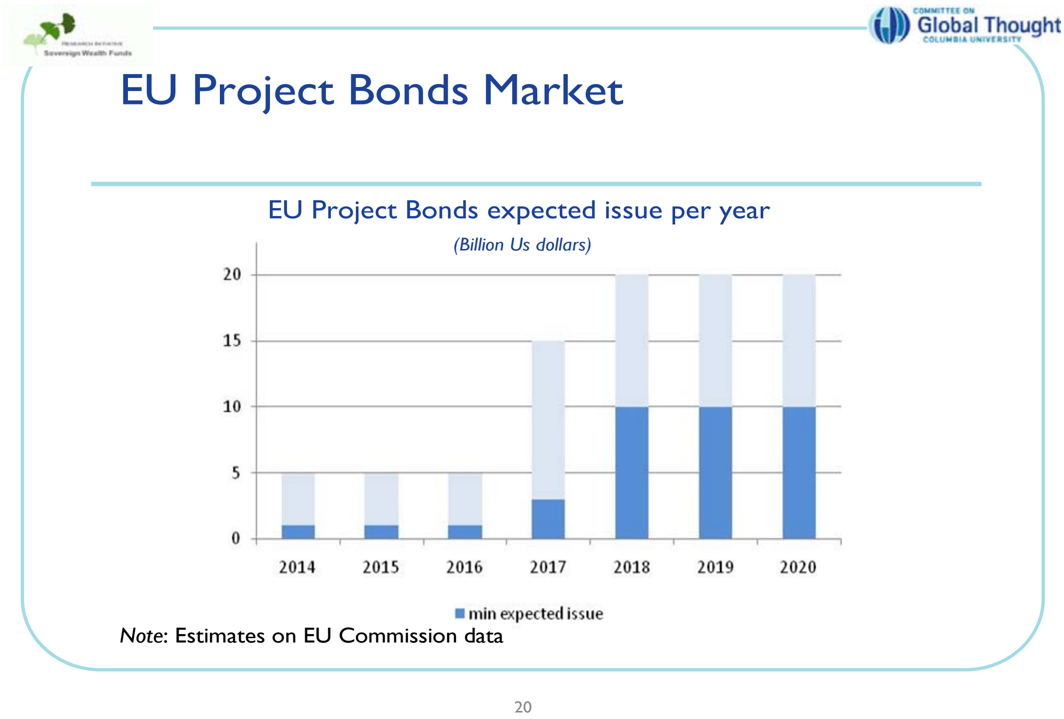
The Initiative aims to attract additional private sector financing of individual infrastructure projects by improving the rating of the senior debt of project companies, thereby ensuring that this can be placed as bonds with institutional investors.

The Commission's key role will be risk-sharing with the EIB (or other financing partners), enabling them to provide guarantees or loans to support such bonds.

The EU-supported credit enhancement would allow the senior project debt to be issued in the capital markets in the form of a new class of project bonds (“EU Project Bonds”), resulting in reduced funding costs for longer maturities for project entities, while meeting the demand of institutional investors (such as pension funds and life insurance companies) for stable, long term assets.

The Initiative would be available to those projects that are economically and technically sound and cost-effective and that have a real prospect of financial viability.

The European Commission and the EIB's estimated targets for EU Project Bonds' issues in the range of 10-20 billion euros by 2020.



This should lead to the creation of an European EU Project Bonds' market of approximately 36-85 billion within 7 years. Moreover, for the 2014-2020 period, the Commission is proposing a 50 billion euros envelope for the "*Connecting Europe Facility*", regarding infrastructure investment; some of these funds could be used for project bonds. In particular 6.4 billion euros would be earmarked for broadband TLC infrastructure, largely in the form of equity, debt or guarantees.

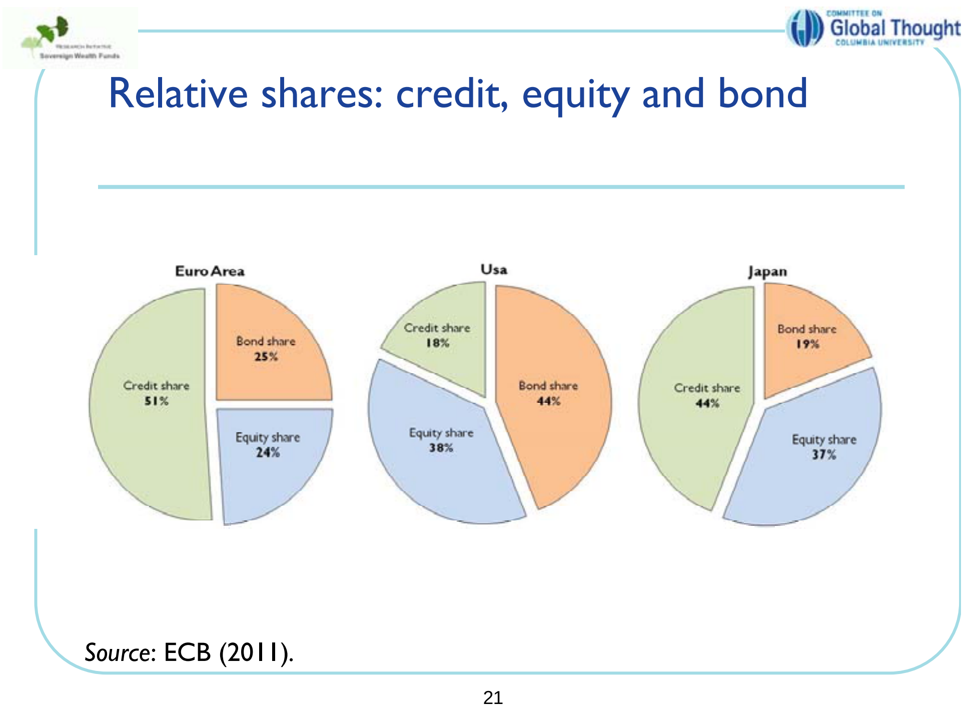
The Commission and EIB would also provide credibility, and improve the projects' credit rating by absorbing part of the risk. In this way EU money would leverage other private and public investment[3].

[3]For instance the 6.4 billion euros envelope could generate up to 100 billion euros in ultra-broadband investment – over one third of the estimated figure needed to meet EU Digital Agenda targets (Neellie Kroes, *Investing in digital Networks: a Bridge to Europe's Future*, Etno FT CEO Summit, Brussels, 3 Oct 2011, in http://www.astrid-online.it/--informaz/Studi--ric/SPEECH-11-623_EN-1-.pdf)

There are differences between project bonds in the US and in the EU. The US has historically an homogeneous market for project financing with well-established companies and authorities with good track records in issuing long term revenues streams bonds back by infrastructure initiatives.

This has been possible also thank to a stable regulatory framework and an efficient judicial system. In Europe, on the contrary, the regulatory framework and the quality of the judicial systems differ greatly by country, the experience of project financing initiatives is not as developed as it is overseas, and the financial markets are not accustomed to these type of financial instruments as much as in the US, where municipalities and local authorities have been using project financing initiatives for long time.

If in the US capital market instruments to finance infrastructure are more widespread, in Europe banks, the EIB and the major national development banks, play a larger role in financing infrastructure.



The US financial system is market-oriented, while the European is more bank-oriented. There are pros e cons in the two systems, and there is a process of convergence and mutual confrontation which goes on from some time now. This is one of the reasons why the US is planning to create a new “National Bank for Infrastructure”, looking at the EIB model[4]; while Europe is trying to create a market for project bonds trying to learn from the American experience.

The European Investment Bank (EIB) and the other public development banks such as the German KfW, the French CDC, the Italian CDP, and others - gathered together in the so-called “Marguerite Network” - are playing a key role in financing long term investments and designing new financing instruments, in line with the new EU institutional framework.

Finally some European countries, such as France and Italy, have recently created large Private Equity Funds owned by their large national public saving banks (and eventually, by the Governments and other national investors), such as the French *Fonds Strategique d’Investissement* (owned 49% by the French Government and 51% by CDC) and the Italian *Fondo Strategico Italiano* (owned 90% by CDP).

[4]“State and local governments – writes Felix Rohatyn a senior NY investment banker who is the father of the proposal for the new US Federal Bank for Infrastructure - generally can borrow for infrastructure purposes in line with their ability to service debt and the strength of their credit ratings. The issue here is not the efficiency of capital markets but rather the efficiency with which federal programs work and spend funds. The purpose of the National Infrastructure Bank would be to use federal resources more effectively and to raise additional funding. We propose this bank because we believe that markets for capital do work and can be harnessed to solve the critical shortfall in funding infrastructure” (*New York Review of Books*, 2008)

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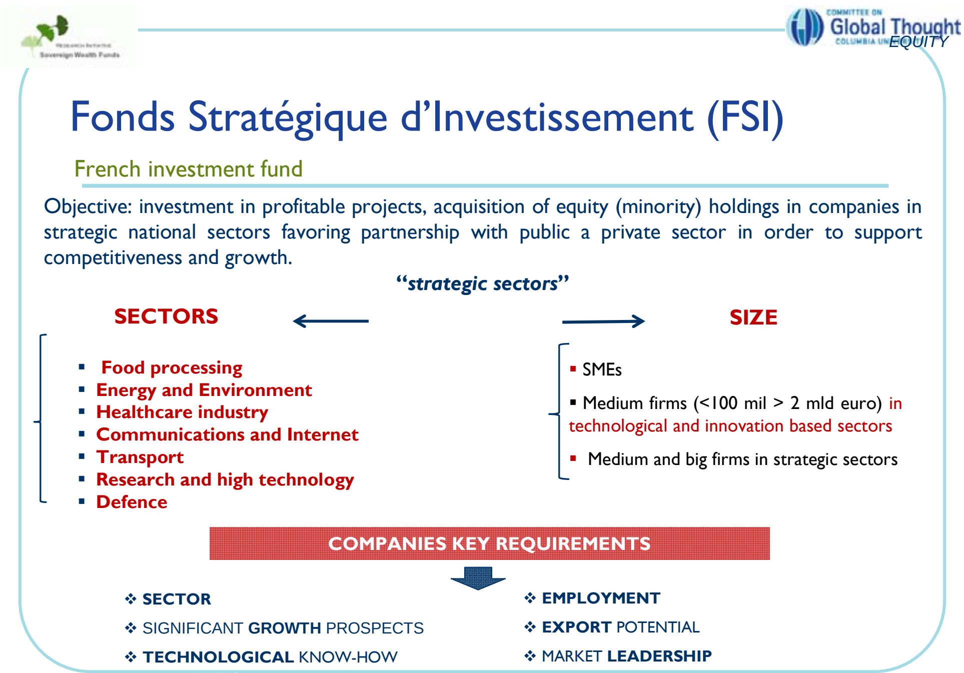

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The two Funds will invest in minority shares of high potential growth companies in strategic sectors of the economy, including project financing in brownfield/greenfield initiatives. With 20 and up to 7 billion euro own funds respectively, they could become major players in finding potential foreign partners and attractive investments in their own country. Thanks to CDC and CDP “institutional endorsement”, to their high reputation and to their strong knowledge of the national context, they may then become important attractive “poles” for SWFs and other global investors**.**

To conclude. New architectures for equity funds, project bonds, debt instruments and, more generally, credit-enhancing initiatives are now emerging numerously both in Europe and in the US.

The creation of new long term financial instruments – backed by Governments’ tax exemptions or by public guarantees – may represent one way to attract private capital in an age of strong budget constraints and though competition for capital investment in the global financial market.

To raise the potential success of these initiatives, a new regulatory framework, including accounting and regulatory rules, fiscal incentives, and a common and technically strong framework for project financing initiatives, is needed.

This agenda should be at top of the attention of the international regulators and of the policy makers – not only in the European Union and in the USA, but all over the world.

Thank you!