

“PUTTING SWITZERLAND AT THE HEART OF SDG FINANCING”

MESSAGE TO THE SWISS FINANCIAL AUTHORITIES FROM THE SWISS PRIVATE SECTOR DEVELOPMENT FINANCE COMMUNITY

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The Swiss private-sector actors working in development finance in emerging and frontier markets have grown to become, as a group, the global leader in terms of assets under management, global outreach, market positioning and innovation.

We see development finance foremost both as: (1) an attractive long-term investment opportunity for our pension and savings system, as well as (2) an excellent policy tool favoring global banking stability, international development cooperation, positive immigration alternatives, climate resilience, or more generally, sustainable development. Policy-making bodies thus have a double rationale, both financial and normative, to address such a prevalent topic and growing market opportunity.

We view private sector investments in development finance as a part of sustainable finance, as the key to contributing to a sustainable and prosperous economy. For the purpose of this declaration, we define it distinctively as investing through private debt and equity instruments into the real economy in emerging and frontier markets, with a view to creating both sound financial return and positive development impact.

We believe the Sustainable Development Goals (SDGs), articulated under the United Nations 2030 Agenda for Sustainable Development, adopted by all member states in 2015, offer an effective framework and platform to push our industry to the next level.

We recognize the pioneering and catalytic role played by our government agencies, in particular by the State Secretariat for Economic Affairs (SECO) and the Swiss Agency for Development Cooperation (SDC), through investment promotion, capacity building and impact measurement. We nevertheless invite the Swiss financial authorities to substantially strengthen their support to our sector by improving our enabling environment, in order to secure, grow and mainstream our practice in the global marketplace.

Switzerland should seize the opportunity to anchor itself at the heart of SDG financing, becoming by 2030 the reference business hub for private sector development finance.

We believe much more is needed to achieve this objective, improving our framework conditions to create a competitive enabling environment for the private sector to thrive, which is not possible without committed financial authorities and appropriate public-private partnerships which can scale up our industry.

We have been greatly encouraged by the Federal Council sustainable finance discussion on June 26th 2019, and its desire to consult industry actors in order to increase competitiveness and innovation in our financial center. We similarly wish to voice our views on the general direction of the forthcoming 2021-2024 federal credit framework for development cooperation.

We hope this message will serve this purpose.

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We ask the Federal Council, and the Federal Departments it represents and manages, in coordination with and support from the Federal Parliament, as well as our financial regulator (FINMA), to develop the framework conditions, policies and practice that would enable the three following objectives that we are putting forward:

1. Investor needs and expectations.

We suggest improving the enabling environment for Swiss investors wishing to invest in products addressing SDGs in emerging and frontier markets, in particular for a) Swiss pension funds, b) Swiss private foundations, and c) Swiss private and retail investors. Lack of favorable or consistent framework conditions are very often pointed out as the main impediment to growth, by wealth managers wishing to assist asset owners to invest in development finance products. We recommend that a thorough review of these framework conditions be carried out on the basis of a comparative study analyzing peer country best practices in this field. Such a review should pave the way for a broad policy dialogue on improving Swiss investors' access to development finance products, enabling lawmakers to unite politically towards this goal. Reviewing and removing barriers to entry in order to set development finance investments on equal footing with mainstream investments is a necessary step in order to achieve scalability. We believe laws and regulations need to be coherently aligned with the need for widespread private sector capital mobilization, inherent to the goal of SDG financing.

2. Financial center promotion.

We suggest that our government launch a strong development finance diplomacy strategy, by systematically promoting Switzerland as the logical turn-to business hub for foreign investors attracted to investment products and solutions addressing SDGs in emerging and frontier markets. These promotional efforts could build on the existing network of Swiss representations abroad or be inspired by the *Swissnex* model for technology companies, promoting Swiss expertise in SDG financing. We also acclaim the *Building Bridges Week* and *Summit* initiative, anchoring our unique ecosystem in the international landscape of financial centers, leveraging natural synergies between historical government neutrality, international organizations, institutional investors, private banks, multinational corporations, academic spheres and non-governmental organizations. We strongly recommend repeating this type of event regularly, which resonates globally, federates domestically and furthers the goal to create a leading market place for SDG financing.

3. Investment capacity and expertise.

We suggest that the country's official development assistance (ODA) should be coherently and materially put forward, aligning the instruments and approaches of SDC and SECO, as well as other federal departments, in order to leverage and scale private sector capital, and make the most of public sector contributions, including through public private partnerships involving private donors. We would in particular welcome additional efforts and initiatives aimed at catalyzing, incubating and enhancing expertise, innovation and mobilization, geared towards addressing SDG financing needs. We also believe that in order to achieve this goal, policy makers should include development finance and impact investing in their training curricula for finance professionals, in coordination with our leading academic centers and organizations. We finally think that, given the fintech edge emerging in Switzerland, digital innovation should be considered as a key asset in promoting Switzerland as a center of excellence for SDG financing.

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More information...

WHAT IS DEVELOPMENT FINANCE

Private sector development finance has emerged in the wake of development finance institutions, multilateral development banks and more general public sector financing of private sector business with a development impact purpose. Its practice can be defined for the purpose of this communication as offering private debt and private equity investments into the real economy in emerging and frontier markets, with a view to creating both sound financial return and positive development impact. It includes topics such as microfinance, small business finance, sustainable agriculture, community development (affordable housing, sustainable infrastructure, clean utilities, etc.), renewable energy (hydro, solar, waste, wind, etc.), affordable healthcare and education, etc. It is currently well framed by the SDGs.

Private sector development finance is represented by specialized asset managers and dedicated investment funds, standing out by seeking to pursue an investment philosophy geared towards sustainable, inclusive and impact finance in emerging and frontier markets.

- **Sustainable finance** in the sense of following environmental, social and governance (ESG) principles, that may be illustrated by the PRI (Principles for Responsible Investing).
- **Inclusive finance** in the sense of following an investment strategy that serves the base of the pyramid (BOP), investing with a view to create inclusive growth to the benefit of low and middle-income households (LMIHs) and micro-, small and medium enterprises (MSMEs).
- **Impact investments** in the sense of positively addressing a range of global challenges, which may be illustrated currently by the SDGs (i.e. no poverty, zero hunger, good health and well-being, quality education, gender equality, clean water and sanitation, affordable and clean energy, decent work and economic growth, etc.).

As a result, development finance investments stand out from mainstream investments by the fact that they pursue a double bottom line, with a development impact promise that is implemented through upstream stated-intent and downstream measurement, centered either on social or environmental objectives they seek to achieve. They typically include (1) pre-investment ratings, (2) transactional covenants binding the use of funds to the targeted goals, and (3) post-investment reporting, on (a) the investment output produced, on (b) the investment outreach achieved in terms of breadth and depth into bottom of the pyramid population, and in some cases (c) on the ex-post outcome results delivered, attached to their specific stated-intent.

Development finance investments do not need to compromise on their risk return profile against mainstream investments. The track record of the investments they represent has been very solid over the past two decades, inducing a doubling of assets under management in the past four years in Switzerland. In particular, a growing number of pension funds, insurance groups, global banks and large asset managers across the globe are embracing this asset class. In Switzerland in particular, most leading financial institutions are positively awaking to this new reality.

WHY IT MATTERS

Private sector investments in development finance have stood out in the banking sector in Switzerland in the past two decades, in an overall challenged global financial system context. This positive asymmetry can be explained by diverging macro-economic conditions at home in Switzerland and other advanced economies, and abroad in emerging and frontier economies.

Indeed, high income countries such as Switzerland have been experiencing in recent decades a structural challenge in organizing their financial systems, in the sense that: (1) their population dynamics have been shifting towards low to negative growth, and (2) their economic growth perspective is similarly low. (3) Interest rate markets are also structurally in low to negative territory, with little avenue for long term stable investment income planning. (4) Paradoxically their savings rates, pension contributions and monetary markets are very significant, with strong deployment pressure, needing products and investment opportunities. Most importantly, with little attractive long-term yields, capitalistic wealth planning is losing its social security function.

Pension schemes in particular were designed in periods where population growth, economic development, interest rates and investment opportunities were much more attractive. Pension plans now face a bleak prospect of either continuous political replenishing increasing the government deficits and debt burden, or structural reform increasing social strife between generations and unrest for the elderly. Neither option is sustainable financially and politically. In one way or another, money will need to flow out of saturated and low yielding markets into more attractive and sustainable value propositions, in high demand for capital.

On the other hand, low- and middle-income countries are experiencing asymmetric structural challenges, in the sense that they have positive to high population growth. The United Nations has released in June its *World Population Prospects 2019*, confirming that the planet will grow its population from 7.7 billion to 9.7 billion by 2050, heading up towards 11 billion by 2100. This growth will essentially take place in low- and middle-income countries; put differently, every day that goes by in the next 30 years, the world will experience a net increase of 180,000 people, essentially born in low-income households in low-income countries. Africa alone will account for half of that growth, moving from one billion today to two billion in 2050, and set to double again to four billion by 2100.

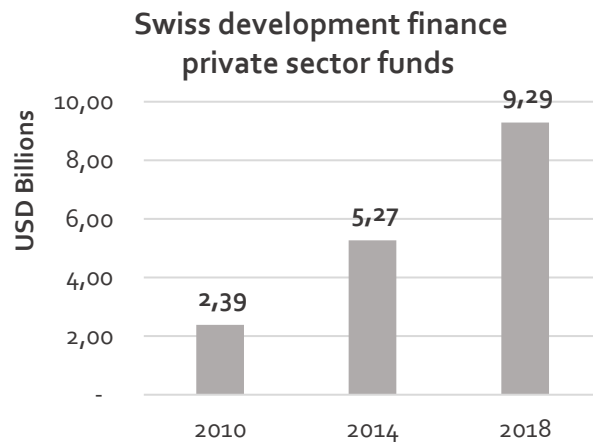
This population growth is paralleled by important technology and knowledge transfers, often allowing these economies to leapfrog and accelerate their economic development, which is forecasted at 5 to 6% per annum in the coming years, some peaking closer to 10% per annum. Their investment and banking markets are thriving as a consequence, growing in double digits on average every year. Their economies are nevertheless nowhere near the leverage known in the high-income countries, with very little indebtedness (public and private debt usually account for less than 1x the GDP in the former, compared to 3 to 5x in the latter), with very little banking penetration (in Africa for instance less than 25% of the population has ever been in contact with a financial institution) and inversely quite attractive interest rates (both in nominal and real terms).

As a consequence, attractive long-term stable return opportunities are plentiful in lower income countries, tied to sound macroeconomic development and value creation opportunities. They open avenues for important capital flows, which are also essential in sustaining rapid social changes and aspirations triggered by such growth there.

SWISS PRIVATE SECTOR DEVELOPMENT FINANCE

Switzerland leads private sector development finance worldwide, in terms of investment volumes and number of funds managed. The 2019 *Swiss Microfinance & Impact Investing Report* shows a global market share of 32% in terms of impact assets under management (AuM) for Switzerland. These impact assets have grown by 18.5% per annum since 2010, from a base value of USD 2.4 billion to USD 9.3 billion at the end of 2018. If many funds remain today focused on microfinance (28 out of 54 reviewed), the number of those focused on energy, agriculture and small enterprises have nearly doubled since 2014 (from 8 to 14), and new ones have emerged in topics such as healthcare, biodiversity, fintech, sustainable infrastructure and climate resilience. For microfinance funds alone, the 2019 *Microfinance Investment Vehicle Survey* positions the country at 40% of market share, in terms of AuM, in front of the Netherlands (20%) and Germany (16%).

We believe this pace of one USD billion growth per annum will most certainly continue, if not accelerate. It could be much larger, in multiples of double digits. Contrary to other peer countries, Switzerland stands out as not having a large independent development bank, like in the Netherlands or Germany for instance, setting the stage, creating a pull factor for private sector firms. Nor does it have strong top down political agenda and culture pushing larger financial institutions into the pond, like in France for instance. If it wishes to keep its edge, and eventually become the lasting reference place for SDG financing, the Swiss public authorities could work into optimizing the enabling environment and framework conditions for the private sector to continue thriving.



Source: Swiss Microfinance & Impact Investing Report 2019