16 September 2014

Update on financial regulatory factors affecting the supply of long-term investment finance

Report to G20 Finance Ministers and Central Bank Governors

I. Summary

In February 2013, the FSB provided an initial report to G20 Finance Ministers and Central Bank Governors which identified Basel III, over-the-counter (OTC) derivatives market reforms, and the regulatory and accounting framework for different types of institutional investors as reforms that may affect the provision of long-term investment finance. In August 2013, the FSB provided an update to G20 Ministers and Governors and outlined next steps in the work.[1]

At the St. Petersburg Summit in September 2013, the G20 Leaders looked forward to the FSB's ongoing monitoring of the impact of financial regulatory reforms on the supply of long-term investment financing. This note describes the FSB's further monitoring work since then, which has consisted of:

- a survey of FSB members to collect inputs on any specific regulatory reform areas that may have had material unintended consequences on the provision of long-term finance and to identify and review any proposals for potential reforms to international financial regulation that could be taken to facilitate the channelling of funds to support long-term investment without compromising prudential and financial stability objectives;
- continued engagement with practitioners in long-term finance from the private sector to understand and assess whether and how regulatory reforms are affecting the provision of long-term finance for investment, including in the light of recent developments in the market;
- consultation with FSB Regional Consultative Groups (RCGs) on the potential impact of financial regulation on long-term investment; and
- work by the FSB Secretariat together with the staff of the IMF, World Bank and OECD to develop a set of key quantitative indicators that summarise the main developments in the provision of long-term finance across different types and regions.

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[1] At the G20 Finance Ministers and Central Bank Governors meeting in November 2012, the FSB was asked to undertake diagnostic work, together with other relevant international organisations, to assess factors affecting long-term investment financing. The FSB's February 2013 report to the G20 is available at http://www.financialstabilityboard.org/publications/r_130216a.pdf and its August 2013 report to the G20 is available at http://www.financialstabilityboard.org/publications/r_130829g.pdf.

The FSB's monitoring continues to find little tangible evidence or data to suggest that global financial regulatory reforms have had adverse consequences on the provision of long-term finance. The reforms are intended to be proportionate to risks and to support financial stability. They are not designed to encourage or discourage particular types of finance.

With most regulatory reforms still at an early stage of implementation, it remains too early to fully assess their impact on the provision of long-term finance or changes in market behaviour in response to these reforms. Indeed, authorities and market participants both note that regulatory reforms need to be finalised and fully implemented in order to reduce uncertainty in the market and achieve the intended effects. The regulatory community will remain vigilant to avoid material unintended consequences and to analyse potential impacts as implementation proceeds. The FSB's monitoring has highlighted a shortage of consistent data on long-term investment finance for analysing the impact of regulatory reforms. This illustrates the potential merits of the project to develop standardised definitions for quantitative indicators of long-term investment finance, that could be collected in a comparable fashion across countries.

Going forward, the FSB will continue to monitor impacts, including to identify any potential financial regulatory impediments to the promotion of market-based financing, to the development of new instruments to finance long-term investment, or to the supply of long-term financing by either domestic or foreign intermediaries. The impact of financial regulation on the provision of long-term finance for investment will be reviewed under the FSB's general monitoring framework[2] to avoid duplication and to ensure continuity of monitoring.

II. Findings

Background: Studies of the impact of financial regulatory measures on economic activity and the cost of credit

As the FSB noted in its original report in February 2013, the most important contribution of financial regulatory reforms to long-term investment finance is to promote a safer, sounder and therefore more resilient financial system. If implemented in timely and consistent manner, these reforms will help rebuild confidence in the global financial system and reduce procyclicality, which will enhance the system's ability to intermediate financial flows through the cycle and for different investment horizons. For this reason, the G20 regulatory reform programme is supportive of long-term investment and economic growth.

A number of studies have been conducted by international organisations (IOs), including BIS, BCBS, IMF and OECD, to analyse and assess the benefits and costs of key elements of the financial regulatory reform programme in advance of implementation.[3] For an overall

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[2] See http://www.financialstabilityboard.org/activities/implementation_monitoring/index.htm for details.

[3] Major studies include the BCBS long-term economic impact (LEI) study conducted in 2010 (See http://www.bis.org/publ/bcbs173.pdf), the BIS Macroeconomic Assessment Group (MAG) review of the transition to stronger capital and liquidity requirements undertaken in 2010 (See http://www.bis.org/publ/othp12.pdf and http://www.bis.org/publ/othp12.pdf) and higher loss absorbency for G-SIBs in 2011 (See http://www.bis.org/publ/bcbs202.pdf), studies by the IMF on assessing the cost of financial regulation in 2012 (See http://www.imf.org/external/pubs/ft/wp/2012/wp12233.pdf) and OECD on macroeconomic impact of Basel III in 2011 (See http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2011)13&docLanguage=En). In addition, the BIS Macroeconomic Assessment Group on Derivatives (MAGD) published a study assessing the macroeconomic impact of OTC derivatives reforms in 2013 (See https://www.bis.org/publ/othp20.pdf).

assessment, the benefits from lowering the probability of crisis must be weighed against the costs associated with investing in additional financial system safety.

In particular, the BIS has coordinated major studies on behalf of the BCBS and FSB of the projected macroeconomic effects of financial reforms. Setting benefits against costs,[4] these studies showed significant expected net benefits to cumulative economic growth in the medium-term from the Basel III reforms applied to banks, as well as separately from OTC derivatives market reforms.

As a complement to the studies undertaken *ex ante* on the potential impact of reforms, the BIS has recently published a study on how banks have adjusted their capital ratios between 2009 and 2012.[5] According to the study, banks have raised significant amounts of additional capital in recent years[6] mostly achieved by accumulating retained earnings. The effect of the rise in capital costs in terms of lending spreads appears modest and banks in aggregate have not cut back sharply on asset or lending growth as a consequence of stronger capital standards (although European banks saw a slight decline in asset and lending growth).[7] These findings are generally in line with IOs' prior assessments. A key finding of the study is that banks that came out of the crisis with higher capital ratios or banks with stronger profitability in the post-crisis years have expanded their lending more than other banks. This points to the importance of solid bank balance sheets in supporting lending and overall economic activity.

Survey of the FSB membership

The FSB's survey of its members was undertaken in May 2014. Members noted that the objectives of the reforms are to promote a robust and resilient global financial system, which will improve the intermediation of financial flows through the cycle and over different investment horizons. The responses from the survey are consistent with the findings from the earlier IOs' studies that the total benefits of the financial regulation (e.g., reduced probability of financial crisis) are expected to outweigh the additional costs financial regulatory reforms may impose on financial intermediaries, and that reforms seek to better align providers and users of finance in accordance with their respective investment horizons and risk-bearing capacity.

Members reported that it is too early to fully assess the effect of regulatory reforms on the supply of long-term finance investment since many of the reforms are still in the early stages of implementation and some are still in the process of being developed. Moreover, it can be

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4 The benefits of reforms arise from the reduced probability and severity of financial crisis, and thus to the reduction of economic losses due to crises over time. The BCBS (LEI) study estimated the median cumulative losses of a banking crisis to be about 60% of annual GDP based on historic experience. On the costs side, the common approach adopted in these studies is to estimate the increase in the cost of banks' lending from higher capital and liquidity requirements, and to model the impact of higher lending spreads on economic activity.

5 See http://www.bis.org/publ/work443.pdf.

6 For example, under Basel III definitions, large international banks increased their capital ratios by some 3 ½ percentage points between 2009 and 2012 on average (from 5.7% to 9.2%).

7 For example, the BIS study shows 14.4% aggregate growth in bank assets for all sample banks between 2009 and 2012, 7.3% for banks in advanced economies and 53.3% for banks in emerging economies. Against the trend European banks showed a 1.1% decrease.

difficult to disentangle the effects of regulatory changes from other broader economic factors that affect the supply and demand of long-term financing investment.

Similarly, members reported that there was, as yet, no empirical evidence or data suggesting that internationally agreed regulatory reforms have had material adverse effects on the provision of long-term finance in their jurisdictions. Most reported that no material evidence of shortage in supply of long-term financing investment has been observed. Banks' credits to long-term investments have been relatively constant or growing over recent years and market-based long-term financing has been showing rapid growth.

Based on their own experiences or on reactions from local market participants, some members suggested areas that could benefit from further monitoring. These areas are similar to those reported in the previous FSB reports - Basel III; reforms to over-the-counter (OTC) derivative markets; as well as the regulatory and accounting framework for different categories of institutional investors - and are set out in more detail in the annex to this note.

On the Basel III capital framework, some members suggested that there could be instances where banks' risk-adverse behaviour would be reinforced by implementation of Basel III, leading banks to become more reluctant to lend at long-term maturities. On the Basel III liquidity framework, banks might be incentivised to hold shorter-term assets to better match maturities of assets and liabilities rather than to extend the maturity of their liabilities. Some members also suggested that the OTC derivatives market reforms might increase costs, and that increased demand for high-quality collateral could encourage long-term investors to liquidate other types of assets, including some types of long-term assets, that might be higher yielding but less useable as collateral. In Europe, there were concerns that Solvency II (when implemented) might reduce insurance companies' investments in long-term assets, and risk charges under the standard model might disproportionately increase with the maturity of assets. Some also suggested that the effects of changes in accounting standards should be monitored, to determine whether fair value accounting for financial assets and liabilities (notably for insurers) could adversely affect long-term investment decisions.

Members emphasised that the regulatory reform programme was just one of the factors potentially influencing long-term investment finance. They also reported a range of other broader economic factors may have contributed to changes in the demand for, and supply of, long-term finance, including prolonged low interest rates and the country-specific investment climate (e.g., stability in macro-economic environment; growth prospects; predictability in the overall policy and regulatory regime for long-term investments; and tax incentives).

Members also noted particular features of domestic financial systems that may contribute to potential unintended consequences of financial regulation, notably the dominant role of banks in the credit market; low domestic retail savings; underdeveloped domestic capital markets; and lack of alternative sources of long-term investment financing.

Members noted that, where regulatory uncertainty exists, it can hinder long-term planning. They therefore suggested that financial regulatory reforms should be finalised and implemented as soon as possible without compromising prudential and financial stability objectives. A diversified financial system with more direct financing from capital markets and

a revival of a simple and transparent securitisation market[8] were highlighted as some of the most important features in promoting long-term investment financing.

See Annex for a more detailed summary of findings.

Engagement with private sector practitioners in long-term finance

The FSB organised in June 2013 a workshop for official sector and private sector participants to assist in the identification of specific financial regulatory factors that may have an effect on the provision of long-term finance. A summary of the main findings from the workshop was attached to the FSB's August 2013 report to the G20. Since then, the FSB has regularly conducted follow-up interviews with the private sector attendees at the workshop.[9] The findings from the follow-up interviews are generally consistent with findings from the 2013 workshop and those from the survey of FSB members outlined above.

- There is no shortage of funds available for long-term investment, with increased competition between institutional investors (e.g., insurers, pension funds, private placement funds) and banks for long-term investments. However, there is a lack of properly structured long-term investment or infrastructure projects. Most projects entail complex legal and financial arrangements, requiring expertise on the side of both the borrowers and the lenders.
- Some respondents cited regional initiatives such as Solvency II in the EU as the financial reforms most likely to affect availability of long-term investment finance. Some noted recent amendments to the risk-weights proposed by European Insurance and Occupational Pensions Authority (EIOPA) would help to support securitised credit, but some also suggested that risk-weights still could better reflect the underlying risk on long-term investments.
- Regarding Basel III, the revisions to the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) and leverage ratio had addressed some of the concerns previously raised by banks and reduced regulatory uncertainty. Some respondents felt that Basel III was constraining long-term lending, but did not offer specific examples.
- On OTC derivatives market reforms, some expected increased costs of hedging due to collateral and margin requirements on long-term positions. Some noted the need for highly liquid collateral could force long-term investors to liquidate some of their holdings to satisfy increased margin and collateral requirements.
- Respondents noted that greater regulatory certainty and the better understanding of risks by regulators and investors that would result from the reforms would be positive for long-term investment. In particular, current regulatory initiatives need to be completed.

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[8] For example, the European Central Bank and Bank of England jointly published in May 2014 a discussion paper on *The case for a better functioning securitisation market in the European Union* (See http://www.bankofengland.co.uk/publications/Documents/news/2014/paper300514.pdf).

[9] The participants in the follow-up interviews included practitioners from banks, insurance companies, pension funds, asset managers, accountancy firms, credit rating agencies and members of academia.

Consultation with FSB Regional Consultative Groups[10] (RCGs)

FSB RCGs for the Americas, Asia and Sub-Saharan Africa discussed the potential impact of financial regulation on long-term investment finance. Some emerging market and developing economies (EMDEs) lack sustainable financing to meet their long-term investment objectives and weak financing capacity is exacerbated by low levels of income and savings, shallow capital markets and lack of financial expertise. For some EMDEs, government support (e.g., guarantees and export credit schemes), and overseas development assistance are important elements of funding for long-term projects, and infrastructure investments in particular.

Some noted that international banks have been the main source of long-term funding for EMDEs in the past and suggested that it is important to monitor the impact of Basel III on the availability and lending tenors of bank funding. EMDEs also stressed the importance of foreign direct investment and the development of local currency bond markets. Development of a robust financial system to support intermediation of funds and providing incentives (e.g., tax incentives and guarantees) to market participants were suggested as some of the effective ways to promote long-term investment.

Key indicators work

To address the point made repeatedly during the G20 work on long-term investment finance that there is currently a shortage of readily accessible, consistent and comparable data on which to base policy analysis and conclusions, the staff of international organisations – FSB, IMF, OECD, and World Bank – have initiated a project to develop a set of key quantitative indicators that summarise the main developments in the provision of long-term finance. These indicators would aim to cover volumes, maturities and costs broken down by funding destinations, instruments, and sources of funds across both regions and time.[11] The group has worked closely with a national engagement group of experts which have provided evidence and analysis of a series of national use cases drawing on national data sources.

An initial stock take of data definitions and availability has been conducted, drawing on information sources currently available to IOs and national authorities. The work does not set out to provide a comprehensive overview of every potential data source, but rather to outline the respective merits (and in some cases limitations) of a number of commonly used information sources and to provide some illustrative charts and tables that may be helpful to policy makers.

The initial phase has assessed the available data in the long-term investment finance area. This has highlighted that currently available data in this area are patchy and incomplete and, while they support some assessment of overall conditions and trends, they do not provide sufficient break-downs by either maturity or types of long-term investment finance to be able to make a precise analysis. Next steps may consequently include consideration of the merits

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[10] The FSB has six RCGs (for the Americas, Asia, the Commonwealth of Independent States, Europe, the Middle East and North Africa, and Sub-Saharan Africa) to facilitate its interaction with a wider group of countries, that bring together FSB members and institutions from 65 non-member jurisdictions.

[11] The project adopted a working definition of long-term finance as equity or debt with a maturity of five years or longer. The project also reviews the scope to monitor broad trends in investment finance from the national accounts, which typically defines long-term finance as lending maturities beyond 1 year.

and costs of introducing a standardised definition of long-term investment finance so that the data collected are comparable, as well as a deeper examination of the usefulness of the available data in a policy context. In doing so, one option for consideration would be for the international organisations to work together with a small number of country experts to produce short, standardised policy notes for two or three economies that would contain a selected number of indicators describing the main developments in investment and long-term finance and attempt to provide an initial analysis of the main factors driving the supply and demand for long-term finance.[12] After discussion of the approach within a broader set of countries, such policy notes could be extended and compiled for other economies. Such an approach could help to determine how best to collect the data necessary to support policy analysis that would include measures drawn from both the finance demand and finance supply side. Such indicators could include:

- *Indicators of overall developments in long-term finance markets;*
- *Trends in long-term capital spending by sector (governments, non-financial corporations) and type of capital projects;*
- *Size, trends and composition of funds raised by sectors undertaking long-term investment projects (by funding sectors, instruments and maturity);*
- *Trends in long-term cross-border capital inflows;*
- *Provision of long-term finance by different finance providers: asset holdings by maturity and type (e.g., banks, insurance companies, pension funds, asset managers, sovereign wealth funds etc.);*
- *Provision of long-term finance by different types of financial product/instruments (loans, debt securities, equity, including retained earnings*[13] *and investment fund shares);*
- *Sources of funds provided for long-term investment by types of investment;*
- *Indicators of finance volumes, duration and cost; and*
- *Derivative transactions and market indicators (by type, maturity, cost).*[14]

[12] Another option for further consideration would be to undertake a small online survey of national policy makers and experts to identify: first, which key indicators they currently track (both from international as well as national sources); and second, which ones they would like to have, but which are not available. Such a survey could complement the suggested tailored policy note approach and ensure that the group can consider a broader set of national experiences.

[13] Recognising, internal finance is an important source of long-term investment finance.

[14] Although not a measure of provision of finance, derivative transactions are very important as a risk management tool for investors and finance providers in supporting long term projects.

ANNEX

Survey of FSB members on the impact of financial regulatory reforms on the supply of long-term investment financing

Summary of findings

1. General findings

FSB members[15] stressed that the overarching contribution of financial regulation to long-term investment[16] finance is to promote a safe, sound and resilient financial system, which will improve the intermediation of financial flows through the cycle and over different investment horizons.

Members emphasised that the total benefits of the financial regulation (e.g., reduced probability of financial crisis) are expected to outweigh the additional costs financial regulatory reforms may impose on financial intermediaries. The reforms induce a re-pricing of risks, which creates costs, but these are more than offset in the long run by the benefits of avoiding the excessive risk-taking that arose from previously under-priced risks in the market. Any evaluation of the effect on credit conditions needs to take into account the fact that pre-crisis models and levels of financing were unsustainable and financial regulations should seek to better align providers and users of finance in accordance with their respective investment horizons and risk-bearing capacity.

Members reported that it is too early to fully assess the effect of regulatory reforms on supply of long-term finance investment since many of financial regulatory reforms are still in the early stages of implementation[17] or are in the process of being developed. It can be difficult to disentangle the effects of regulatory changes from other broader economic and policy factors that affect the supply and demand of long-term financing investment (e.g., increased risk aversion, uncertain market conditions, monetary policy interventions and low interest rates).

Members did not find any material evidence or available data suggesting that internationally agreed regulatory reforms have had a material impact on the provision of long-term finance in their jurisdictions. Most reported that no material evidence of shortage in supply of long-term financing investment has been observed. It was noted that market forces and changes in risk

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[15] FSB members that provided responses to the survey are authorities from Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, and staffs from the European Commission, Basel Committee on Banking Supervision and International Accounting Standards Board.

[16] For the purpose of the survey, long-term investment was defined as investments in productive activities that support growth with a maturity equal to or longer than five years. Examples include investments in infrastructure, long-term projects and corporate facilities.

[17] For example, Basel III capital framework is phasing in from January 2015 and will be completed by January 2019. LCR and NSFR will come into force in 2015 (LCR) and 2018 (NSFR).

management practices had accelerated effective implementation of Basel III.[18] However, most members indicated that bank credits to long-term investments have been relatively constant or growing over the recent years, and that market-based long-term financing has been showing rapid growth.

2. Potential effect of regulatory reforms on supply of long-term investment finance

Potential unintended consequences of reforms identified by members tended to be qualitative in nature, reflecting the early stage of implementation and lack of quantitative impact studies at national level. Members that identified potential unintended consequences from regulatory reforms that may affect long-term financing investment focused on the following areas.

Basel III capital framework

The Basel III capital framework increases overall capital requirements but, in many cases, does not change risk-weights, including ones that apply to long-term investment finance.[19] The relative effect of Basel III on long-term bank credit is not yet clear, but some are concerned that risk-averse behaviour (including deleveraging and a shift towards high quality assets) may have been reinforced by implementation of Basel III, leading banks to become more reluctant to lend in the long-term. Others considered that these effects may reflect a better understanding of the risks of long-term investments. Jurisdictions with well capitalised banking sectors tended to be affected least.

It was indicated that the bank deleveraging process that has occurred in some parts of Europe has to a large extent been driven by changes in bank strategies and de-risking and not so much by regulation. Bank deleveraging is a necessary process to correct the excessive leverage built up before the crisis and to put the banking sector back on a more stable footing. Banks have various options in which to deleverage (e.g., cleaning up their balance sheets by writing down the troubled assets accumulated before the crisis.), and this process does not necessarily have to hamper lending to the real economy.[20]

Basel III liquidity framework

Some members expressed concerns about the potential effect of Basel III liquidity framework[21] (LCR and NSFR) on the provision of long-term finance investment, and the potential effect on the maturity structure of banks' balance sheets. Banks may be incentivised to hold shorter term assets to better match assets and liabilities maturities. It was noted that preferential treatment for sovereign assets and government bonds and their eligibility to the

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[18] According to the April 2014 BCBS Progress report on implementation of the Basel regulatory framework (http://www.bis.org/publ/bcbs281.pdf), 18 out of 24 FSB member jurisdictions have issued the final set of Basel III capital regulations.

[19] For example, the risk-weight on a 10 year 'BB' rated loan remains at 100% under the standardised approach.

[20] The European Commission published in May 2014 a comprehensive review of the financial regulation agenda in Europe, including impact on bank lending (See http://ec.europa.eu/internal_market/finances/docs/general/20140515-erfra-working-document_en.pdf).

[21] The LCR has been designed to require global banks to have sufficient high-quality liquid assets to withstand a stressed 30-day funding scenario specified by supervisors. The NSFR is a longer-term structural ratio to address liquidity mismatches and provide incentives for banks to use stable sources to fund their activities (see http://www.bis.org/publ/bcbs188.pdf and http://www.bis.org/publ/bcbs238.pdf).

liquidity buffer may incentivise banks to prefer them to other long-term as well as short-term assets.

In some jurisdictions there is a lack of high quality liquid assets (HQLA). Where the availability of government bonds is limited owing to low levels of government debt and capital markets are less developed, banks may be incentivised to substitute long-term lending activities, such as infrastructure investment, with shorter-term lending in order to comply with Basel III liquidity framework.

OTC derivatives market reforms

Where concerns were expressed about the impact of OTC derivatives market reforms, these centre around the additional costs through new capital and marginal requirements, particularly for non-centrally cleared transactions. The reforms to OTC derivatives market requires all standardised OTC derivative contracts be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs). Non-centrally cleared contracts are subjected to higher capital requirements. Some raised concerns that margin requirements for long-term transactions (e.g., interest rate swaps and currency swaps) which currently cannot be cleared through available CCPs could increase transaction costs, and consequently make it difficult for end-users to hedge long-term contracts by using those derivatives.

Some noted that the need for highly liquid collateral could force long-term investors to liquidate other types of assets. Increased demand for high quality collateral, compounded by demand for HQLA in meeting standards and requirements in other reform areas (e.g., Basel III and reforms to repo and securities lending markets) may also put an upward pressure on prices of high quality collateral.

Regulation of institutional investors

Although the reforms do not target long-term investment finance, they alter the incentives of different types of financial institutions to participate in this market. As the balance of incentives changes, institutional investors who are the natural providers of long-term funding are more actively participating in the market.

In Europe, some members expressed concerns that Solvency II could adversely affect insurance companies' investments in long-term assets. Internal models facilitate the development a risk-based approach for individual insurers, but risk charges under the standard model may disproportionately increase with maturity of assets. Market based valuations under Solvency II may create an incentives toward holding shorter-term assets to avoid the risk of higher capital charges on longer-term investments which generally entail higher volatility in market values. However, capital requirements under Solvency II also depend on an insurer's asset-liability matching; a better matching of assets to liabilities provides capital relief.[22]

Members also noted that EIOPA had concluded that there was not sufficient statistical evidence that would justify lowering of the proposed solvency capital requirements for any

[22] These include the introduction of the matching adjustment and the volatility adjustment which would help to reduce short term volatility from credit spread movements.

asset classes examined except for securitisations (either because of lack of data or because the data did not support changes to the existing proposed capital treatment).

Accounting framework and standards

Some members expressed concerns that recent and impending accounting changes may adversely affect long-term investment. Some noted that the use of fair value accounting for financial instruments increased volatility in measures of income and capital and so could provoke adverse reactions from investors. There were also concerns that fair value does not reflect the business model of long-term investors, as it can mean that short term changes in value of instruments are given undue weight. This is particularly the case for insurers, whose business model involves matching assets and liabilities, and for holders of strategic equity investments, where recognition of the unrealised fair value gain does not reflect the intention to hold the investment long-term.

There are concerns that the accounts of insurers could be misleading if they are required to reflect gains or losses on assets through the income statement when the matching liabilities are not accounted for in the same way. It was also noted that the standards are still under development, and that the introduction of expected loss accounting for loan provisions will greatly enhance transparency.

Other issues

In addition to international regulatory reforms, a few members expressed concerns about the potential effect of national structural banking reforms on the liquidity of sovereign debt and corporate securities markets; and bank funding via foreign currency swaps. Such potential effects are being reviewed in the FSB's study on national structural banking reforms and their expected cross-border implications, to be published ahead of the G20 Brisbane Summit.

Beyond potential impacts from individual regulatory reforms, some members underlined that unintended consequences could arise from the cumulative effects of regulations, the uncertainty surrounding their calibration and implementation, and lack of consistency across jurisdictions.

3. Broader economic and policy factors also affecting the supply of long-term investment finance

Many members reported other broader factors that may have affected the supply of long-term finance.

- Prolonged low interest rates and unconventional monetary policy, which allowed banks and market players to get access to low cost funding sources and abundant liquidity. This has incentivised the banks and institutional investors toward investing in longer term, alternative asset classes in search for higher yields.
- Stability in macro-economic environment, growth perspective, market participants' attitude toward risk aversion, remaining bad loans in balance sheets, a lack of confidence in financial intermediaries and tax incentives.
- Certainty and predictability in policy and regulatory regimes, transparency in legal framework and consistency in the rule of law.

Particular features of domestic financial systems may also contribute to potential unintended consequences of financial regulation on supply of long-term investment financing. For instance, some adverse effects may stem from the interaction of the reforms with existing financial sector weaknesses such as: the dominant role of banks in the credit market; low domestic retail savings leading to overreliance on wholesale funding; underdeveloped and shallow domestic capital markets; limited access to global funding market; lack of effective competition among financial intermediaries; and lack of alternative sources of long-term investment financing.

4. Proposals for mitigating potential unintended consequences of regulatory reforms

Members suggested that regulatory reforms should be finalised and implemented as soon as possible without compromising prudential and financial stability objectives, which will help reducing the uncertainties in the long-term investment market. A diversified financial system with more direct financing from capital markets, revival of simple and high-quality securitisation market, and encouraging the development of institutional investors are some of the most important features in promoting long-term investment financing.

Possible unintended consequences could be mitigated by sufficiently long phase-in periods; principle based approaches to regulation; consistent and coordinated implementation of regulatory reforms, avoiding any unnecessary cross-border duplication and complexity; enhancement of market transparency and information efficiency; and ongoing implementation monitoring. In general, the capacity of the economy to make long-term financing available depends on the ability of the financial system to channel the savings of governments, corporates and households effectively and efficiently to the real economy.

Members emphasised the need for higher standardisation of market practices to promote market based direct financing and revival of the securitisation market, which could enable banks to refinance loans by pooling assets and converting them into securities that are attractive to institutional investors. Some members also said that a better recognition of risks and the reduction of arbitrage opportunities that may arise from potentially excessive differences in risk weights among different asset classes could help promote long-term financing going forward. Members looked forward to the work of joint BCBS-IOSCO Task Force on Securitization Markets in assessing impediments to the revival of sustainable securitisation markets.