FSB FINANCIAL STABILITY BOARD

29 August 2013

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

Report to G20 Finance Ministers and Central Bank Governors

Introduction

G20 Finance Ministers and Central Bank Governors have recently emphasised the importance of long-term financing for investment, including in infrastructure, in enhancing economic growth and job creation.

At the meeting of the Ministers and Governors in November 2012, the FSB was asked to undertake diagnostic work, together with other relevant international organisations (IOs), to assess factors affecting long-term (LT) investment financing. In February 2013, the FSB reported[1] initial findings to the G20 on the financial regulatory factors affecting the availability of LT investment finance, as part of broader diagnostic work undertaken by IOs. Ministers and Governors welcomed the report by IOs and established a new Study Group on Financing for Investment[2] to consider issues raised in the report. In addition, Ministers and Governors asked the FSB to "*continue to monitor the possible effects of regulatory reforms on the supply of long-term financing*" as one important component of this work.

To support the response to the request, the FSB organised a workshop in June 2013 to identify specific financial regulatory factors that may be impeding the provision of LT finance and that may warrant a policy response at the international level, without compromising global financial stability objectives. This note summarises the main conclusions of the workshop and the implications for future monitoring.

As highlighted in the February FSB report, the most important contribution of financial regulation to LT investment finance is to promote a safe, sound and resilient financial system. It should also be noted that promotion of LT investment itself is conducive to financial stability. If implemented in a timely and consistent manner, reforms to financial regulation will help rebuild confidence in the global financial system, which will enhance its ability to intermediate financial flows through the cycle and over different investment horizons. For this reason, the G20 regulatory reform programme is supportive of LT investment and economic growth.

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[1] See http://www.financialstabilityboard.org/publications/r_130216a.pdf.

[2] The G20 Study Group has identified five core topics as the initial basis for its work: i) country-specific factors that can affect a country's ability to attract LT financing; ii) capital market developments including local currency bond markets; iii) private sources of financing including institutional investors; iv) official sources of financing including the multilateral development banks; and v) implication of global financial regulatory reforms.

The regulatory reforms do not specifically target LT finance. Nonetheless, financial regulation affects market structures and the incentives of different types of financial institutions to participate in different markets, as well as the costs of different types of transactions. As the balance of incentives changes, participants in the capital market and institutional investors which are the most natural providers of LT finance in the financial system will need to assume a greater role in the provision of LT finance.

Main findings of the workshop

Three specific objectives were set for the workshop:

1. To engage with a wide range of official sector and private sector institutions to assist in identification of specific financial regulatory factors impeding the provision of long-term finance that may warrant a response at the international level, without compromising global financial stability objectives.
2. To identify ways that financial regulation could facilitate the channelling of funds to support long-term investment, while continuing to meet global financial stability goals.
3. To provide feedback on the outcome of the workshop to the FSB and the G20 Study Group on the Financing for Investment, as input to the FSB's broader framework for monitoring the effects of financial regulation.

The workshop brought together practitioners in long-term finance from the private and official sector to join representatives from the FSB membership of standard setters, national authorities and international financial institutions[3]. Participants joined from a wide range of backgrounds from across the globe, including: finance providers (banks, insurance companies, pension funds and asset managers, infrastructure funds, sovereign wealth funds, and development banks (multilateral, regional and national)); finance users (commercial companies); project finance developers and facilitators (law firms, consulting and accountancy firms, credit rating agencies); and independent experts (academia).

Sessions focussed on: the key features of long-term investment and the influence of financial regulation from the respective perspectives of arrangers and users of long-term finance on the one hand and of the providers of finance on the other; the impact of financial regulation on hedging long-term risks and use of derivatives; the effect of current and prospective accounting rules on the provision of long-term finance; and finally on innovation in the provision of finance and how financial regulation may support initiatives that could help enhance the supply of long-term finance. The main points made were[4]:

- Participants provided understanding and support for the objectives of financial regulation in promoting a robust and resilient global financial system. Safety and soundness of the global financial system was viewed as an essential pre-requisite to support the provision of long-term finance.

[3] There were over 80 participants at the workshop, split roughly evenly between invited external experts and representatives from the FSB member institutions.

[4] A fuller summary is provided as an Annex.

- Participants nonetheless noted that there is a cost of providing financial system safety which should be considered as part of the standard cost of finance. The challenge for the regulatory community is to ensure that financial regulation is well-designed, in order to deliver the clear benefits of financial system safety, without unduly or disproportionately affecting the efficiency and effectiveness of financial intermediation, or imposing unnecessary costs on the system or particular agents.

- Predictability and stability of the regulatory regime[5] were highlighted as important to both finance providers and end investors. The costs of adjustment should be minimised where possible. Participants consequently urged the regulatory community to complete the global reform agenda as soon as possible. A tension was noted between the desire for greater regulatory simplicity and clarity on the one hand, and the competing objective of greater tailoring of financial regulation to more granular assessments of risks on the other.

- Participants noted the importance of clear and objective assessment of the risk profile and risk components of individual long-term finance projects, of how they are priced and managed, and of who is best equipped to hold them. For example, risks at the construction stage are very different from those at the subsequent stage when projects come on stream. Assessing the impact of financial regulation on the provision of long-term finance consequently needs to take account of the changes in incentives on different finance providers at different steps of the finance chain. A number of participants suggested that additional consideration should be given to the distinction between credit duration and credit risk in terms of regulatory design. In relation to long-term infrastructure projects, for example, the risk of default was typically greater in the early stages of the project than at a later stage when the project generates a steady income stream.

- The necessary deleveraging of overextended banks (particularly in Europe) was leading to some pullback in the provision of long-term finance. Stronger banks in other regions (such as Asia) were filling part of the gap. Tighter bank regulation was nonetheless judged likely to lead to some pressure on the financing of long-term assets and to a shortening of average loan tenors. Some participants advocated greater focus on whether there was a potential financing gap at around a 5-7 year maturity – as this was viewed as on the long side for many banks, but on the short side for a number of institutional investors.

- Institutional investors (pension funds, sovereign wealth funds, insurance companies, asset managers) reported enthusiasm and appetite for long-term ‘seasoned’ projects (such as in the infrastructure sector) at the post construction stage when cash flows were relatively stable. But there were challenges in acquiring suitable risk management expertise and in the costs and availability of suitable financial hedging products in some areas. And a number of participants questioned whether proposed regulatory capital charges on the insurance sector are too high, overestimating the real risks of investing in long-term assets. They consequently welcomed proposals in Europe for further impact assessment and analysis before the calibration is finalised.

- A number of participants proposed that additional attention should be paid to the impact of derivatives regulation on the provision of long-term finance. The higher cost and lower

[5] Including the national business and fiscal regime, as well as the regime for financial regulation.

availability of some hedging products, as well as the opportunity costs from the need to hold (or borrow) liquid collateral to post as margin, were affecting the supply of long-term finance. Some commercial companies noted a trend towards less financial hedging and the increased retention of risks on their balance sheets.

- Workshop participants supported initiatives from the accounting sector to enhance the clarity of financial information in reported accounts and disclosures. It was noted that reporting rules can sometimes have a behavioural impact – the challenge was to deepen understanding and avoid inappropriate market reactions.

- Participants emphasised that markets were continuing to develop and innovate in response to the cyclical and structural forces. New projects were emerging to satisfy gaps in the market, and national, regional and multilateral development banks were also enhancing their catalytic role. Financial regulatory authorities should monitor such developments closely to ensure that the regulatory framework facilitates the channelling of funds to support long-term investment while continuing to meet global financial stability goals.

Implications for monitoring the effects of regulatory reforms on the provision of long-term finance

The workshop provided valuable feedback from market experts on recent developments in the provision of LT finance and on the influence of financial regulation. A number of potential pressure points in relation to the provision of LT finance were highlighted such as: some pullback and shortening of maturities of bank lending; the ability and willingness of institutional investors to provide additional long-duration finance given rising demand and less active involvement of the banking sector; the importance of additional transparency surrounding the performance of LT investments; and the development of the market for hedging of LT risks, which plays an important role in the structuring and overall viability of investment projects.

Since many of regulatory reforms are still in the process of policy development or at an early stage of implementation, it is too early to observe the effects of regulatory reforms on the provision of LT finance. In addition, financial regulation is one of a number of influences that affects the incentives of providers to offer LT finance and financial products, and one of the influences on the identified pressure points. It is also difficult to distinguish the effects of stronger financial regulation from other influences such as the desire of finance providers to improve their internal risk management practices and to hold higher capital and liquidity buffers as a response to the lessons of the crisis. It is also challenging to separate structural factors such as stronger regulation and risk management from the impact of weak growth and continuing deleveraging in major parts of the global financial system.

The potential pressure points noted in the workshop are relevant to the FSB's analysis of regulatory reforms that may affect long-term finance and consequently that warrant close monitoring as outlined in the February FSB report, including: Basel III; reforms to over-the-counter derivative markets; as well as the regulatory and accounting framework for different categories of institutional investors. The FSB has developed a monitoring framework for assessing the impact of these and other regulatory reforms[6], in part to help guard against material unintended consequences and impacts. The impact of financial regulation on the provision of long-term finance for investment will be monitored under this framework to avoid duplication and to ensure continuity of monitoring.

A number of steps will be undertaken by the FSB to this end:

- Co-ordinate with relevant standard-setting bodies (BCBS, IOSCO, IAIS, IASB, OECD), FSB working groups, and other members (IMF, World Bank, European Commission) and potentially non-members (e.g., regional development banks) to draw together information on the effects of regulatory reforms and to ensure that any relevant findings are evaluated by the FSB and reported to the G20.

- Include the impact of financial regulation on long-term investment in the agenda of future FSB Regional Consultative Group (RCG) meetings to solicit views from national financial authorities including non-FSB members on whether any material unintended consequences are emerging.

- Continue the engagement between practitioners in long-term finance from the private and official sector and the FSB membership of standard setters, national authorities and international financial institutions on the impact of financial regulatory reforms on the provision of long-term finance.

In addition, the FSB recommends that the G20 consider how the international community could work together 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. Preparation of such a set of indicators could draw on the respective expertise of the IOs, including the FSB. The preparation should also take into account the importance of a standardised definition of long term finance so that the data collected are comparable. Amongst the potential areas that could be covered are:

- Indicators of overall developments in long-term finance markets;
- 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 products;
- Indicators of finance volumes, duration and cost;
- Derivative market indicators (by type, maturity, cost).

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

Annex: Summary of the Main Points made at the FSB Workshop

Session 1 and 2 – Structuring long-term investment projects and the influence of financial regulation

Participants fully supported the objectives of global financial regulation in delivering a safe and resilient global financial system. Confidence in the stability of the financial system was highlighted as a pre-requisite to the provision and promotion of long-term finance. And the cost of providing financial system safety should be viewed as a necessary component of the cost of finance. The key challenge is to ensure that financial regulation is well designed and calibrated, in order to deliver the benefits of financial system safety without unduly affecting the efficiency and effectiveness of financial intermediation, and the provision of financial services to support the real economy.

Workshop participants highlighted some of the key features of long-term investment projects and the particular financing challenges posed. Using infrastructure as an example, participants emphasised the different risk and cash flow profiles at different stages of the project. In particular the risks and returns at the construction and build stage were very different from those at the subsequent operation stage. An important element of project finance design is consequently to break down projects into different maturity and risk components and to match the risks and provision of finance to those best equipped to hold them. For example, long-term institutional investors are attracted by the opportunities to invest in long duration assets that offered a relatively stable cash flow in the operational phase. But such investors are not typically prepared or equipped to hold the initial construction finance risk.

Any assessment of the impact of financial regulation on long-term finance consequently needs to take account of the changes in incentives on different potential finance providers and risk holders throughout the life of a project. All risks in the project need to be identified and properly managed. If a particular agent is not a natural holder of that risk then a lack of a ready mechanism to hedge or offload the risk could substantially weaken the provision of overall long-term finance. An assessment of the impact of regulation thus also needs to factor in the ease of transferring risks and finance provision between different intermediaries. For example, how easy is it for finance providers holding construction risks to exit the project once the build stage is completed, and for institutional holders to enter at that point? And how easy is it for potential investors to hedge and manage any long-term exchange rate and interest rate exposures?

Participants noted the tensions between the desire for regulatory simplicity on the one hand and for greater tailoring of regulation to risks on the other. For example, a number of participants noted research pointing to different risk profiles and default probabilities between project finance and corporate loans as the maturity of lending increased. Project finance linked to infrastructure, for example, typically experienced a lower default rate once beyond the initial risky build phase. Taking this duration element into account was viewed as important. A number of participants consequently suggested that more granular and detailed analysis of the risk profile of long-term projects of the infrastructure type should be reflected in the regulatory framework, to improve the targeting of financial regulation to the risks. But equally it was noted that greater complexity of the regulatory framework also had drawbacks, and so the necessary balance between the precision of risk-based regulation[7] and the desire for simplicity was a challenging one.

While the need for stronger financial regulation was fully recognised in the wake of the crisis, the costs of changing regulation were also emphasised by many speakers. Such changes could have a significant impact on the attractiveness of long-term projects. And amendments to the overall regulatory framework part way through a project could substantially affect the underlying financial calculus and viability of the investment[8]. Uncertainty regarding the regulatory framework provides an incentive for firms and finance providers to delay large investment projects. Workshop participants consequently called for the completion of the global financial regulatory reform programme as soon as possible to aid long-term planning. Equally, participants noted the importance of effective regulatory design and of a full assessment of the costs, benefits, and impact of new financial regulation before application and acknowledged that this took time. Again there was a need to strike an appropriate balance.

The importance of consistent global implementation of regulatory reforms was highlighted by a number of speakers. Discrepancies in the timing of introduction of measures and in the details of application promoted unhelpful regulatory arbitrage and fragmentation of global capital markets.

Turning to the specifics of project design, workshop participants highlighted the importance of balancing the risks and the costs of different components and types of finance. For example, debt finance is important to lower the weighted average cost of capital of long-term projects as well as to exert discipline. Participants noted, however, that it was possible to alter the risk profile and characteristics of projects by changing the proportion of debt finance and thus of embedded leverage in the project – a number of recent projects had been deliberately structured to achieve a higher credit rating, thus appealing to debt investors with a lower tolerance for credit risks. Such examples of tuning contract design to maximise the attractiveness to different finance providers demonstrated welcome market flexibility.

Participants briefly reviewed potential pressure points in project finance design. Experts noted some challenges in refinancing projects at around the 5-7 year mark. At around that duration, suppliers of initial risk capital to support construction were looking to exit. But it was sometimes too early for the projects to be generating a relatively steady stream of income that appealed to long-term investors. Pressures to shorten the overall tenor of funding were also noted, though some speakers pointed to some recent very long maturity financing and suggested that the market was adapting and innovating.[9] And challenges in hedging long-term risks were also highlighted by a number of participants.

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7 The paucity of high quality data and information to support detailed calibration was also highlighted.

8 Participants noted that the point applied to business regulations affecting particular industrial sectors and to the fiscal framework as well as to the framework for financial regulation. Measures taken by governments to provide guarantees against changes in business regulation and lower political risks were commended by many participants.

9 Funding of 41 years had recently been achieved on a project for student accommodation in the UK for example.

Session 3 – The impact of financial regulation on the provision of long-term finance

Participants turned to the perspectives of different finance providers, addressing in turn: the banking sector; insurance companies; and other institutional investors (such as pension funds, asset managers and sovereign wealth funds).

Many speakers emphasised the difficulties of separately distinguishing the impact of the financial crisis and the weak global economy from changes in structural influences affecting the provision of long-term finance, including financial regulation and changes in risk management practices. The differing experience of regions during the financial crisis coloured the perspectives. In Europe, the major deleveraging of the banking system had led to banks reducing long-term assets and thus shortening the average maturity of assets. The tightening of liquidity regulation in particular was highlighted as a factor narrowing lending tenors – uncertainty surrounding the details of the Net Stable Funding Ratio also added to lenders' caution. In respect of project design, this created pressures on refinancing debt at around the 5 year maturity mark given the desire from a number of banks to limit duration risk, and in finding investors willing to allocate capital on projects with a long construction phase. Other speakers suggested that there was no strong evidence that regulatory reform had a substantial impact on the provision of long-term finance and drew attention to the growing share of long-term finance provided by Asian banks – stability, consistency and transparency of the global regulatory regime were key objectives in their view.

Building strong relationships between project sponsors and project financiers was also emphasised. A number of banks had developed clear expertise in the analysis and monitoring of projects. It was noted that other finance providers often took comfort from the engagement of such sponsors and financiers in a project – while the benefits in relation to building finance syndicates was noted, the risk was that such an approach reduced the incentives for appropriate independent due diligence by finance providers and could encourage 'herding' and a lack of independent technical review.

Insurance company representatives noted the inherent attractiveness of long-term investment projects that provide long duration assets to match long-term liabilities. Infrastructure projects in particular offered attractive diversification benefits. But it was also noted that assessing the risks of such projects required specialist skills which were in relatively short supply. Indeed, some insurance companies had pulled back from such business in the face of competition from banks which had expanded long-term project lending in the decade running up to the current financial crisis. Rebuilding such expertise could take time, although it was noted that it might be possible for such companies to hire former bank staff experienced in the area.

Participants also noted that life insurance companies were primarily interested in the long-term cash flows post project construction phase – they were not a ready provider of finance for the early stages of the project. Achieving an efficient transfer of finance and risk at the post construction phase remained challenging – initiatives to strengthen and rebuild securitisation markets such as the European Prime Collateralised Securities (PCS) scheme could be helpful in this regard.

Participants also highlighted a number of challenges to the supply of additional support for long-term investment from the insurance sector. Several speakers questioned the calibration of risk-based capital requirements for long-term investment finance – in their view there has been inadequate attention paid to research indicating lower default rates on project loans than on corporate debt of the same maturity. Moreover, the weight and sensitivity of capital charges to duration risk was too high in their view. And they also questioned whether there was excess focus on market spread movements (reflecting interim value changes) rather than on exposure to actual defaults. They welcomed the decision of the European Commission to invite EIOPA to analyse further the calibration of European insurance regulation (Solvency II) before the detailed implementation rules were finalised. It was also recommended that such charges should be regularly reviewed in the light of emerging experience to ensure their continued appropriateness. Speakers also noted the importance of long-term hedging products to manage interest and exchange rate risks – such products encouraged greater cross-border investment. The accounting treatment of long-term investment and hedge accounting rules were also highlighted as important elements.

Participants representing the wider institutional investment community (including pension funds, asset management companies, sovereign wealth funds and infrastructure funds) shared a broad interest in supporting low risk long-term investment projects. The relatively stable and predictable long-term cash flows, provided, for example, by infrastructure projects in the operational post-construction phase, could help such investors achieve their investment targets. Such investments also often provided attractive built-in inflation protection. The main challenge was ensuring that such investments were suitably low risk, to reduce the uncertainty of long-term cash flows to a minimum. Stability and predictability of the broad political and regulatory landscape was stressed as a critical element.

Such investors cautioned against characterising long-term investment into a ‘one size fits all’ model. Different investors have a variety of investment horizons and risk appetites which should be kept in mind. For example, although promoting additional greenfield investment in emerging market infrastructure is an important social policy objective, the risks of such investment may be too high for pension funds in advanced economies. Mechanisms to lower risks (for example, through government or development bank support) or to pool risks (for example in infrastructure funds) were important to widen the potential investor base.

Participants from the institutional investment community echoed earlier points that a reduction in bank capacity and shortening of investment tenors was creating additional pressure on such investors to take on additional refinancing risk. Speakers also noted the importance of ensuring that regulatory reform of ‘shadow banking’ took appropriate account of the risks and did not unduly penalise market based finance. Participants also highlighted that national limits on different types of investment by institutional investors could act as an impediment to greater finance provision. And while additional data and information on long-term investment projects could aid improved risk assessment and support regulatory policy, it was also noted that disclosures need to be carefully designed to avoid transparency inhibiting the participation of certain specialist investment funds.

Session 4 – Impact of financial regulation on hedging long-term risks and other aspects of the derivatives markets

Given the importance of hedging and insuring long-term risks as a core component of the financing of long-term investment projects, workshop participants devoted particular attention to the impact of financial regulation on the availability and costs of such instruments. In particular, participants provided feedback on the impact of clearing and collateral requirements on hedging strategies in long-term projects, the potential impact of collateral transformation and futurisation of swaps, as well as the impact of end user exemptions on the cost of hedging of derivatives. Representatives of multinational development banks, pension funds as well as broader financial services participants provided their views.

Workshop participants agreed that when considering the impact of OTC derivatives reforms, factors such as asset class type and geography of the underlier and counterparty are important elements. The particular characteristics of the markets involved need to be taken into account when assessing the influence of regulatory reforms on the cost and availability of OTC derivatives products for hedging particular risks embedded in long-term finance projects.

Financial sector participants highlighted that OTC derivatives reforms will raise the cost of hedging. Multinational development banks noted the impact of OTC derivatives reforms on the hedging of inflation and currency/foreign exchange (FX) risks due to the fact that they engage in long-term (e.g. 12 year) loans, which are often provided in local currencies. Institutional investors also highlighted the importance of such hedging markets to support cross border investments. Participants noted that the prices of such long maturity FX swaps had increased, in some cases by as much as 50 basis points.

Participants noted that in case of long-term finance projects it is the long-term investors who are the primary users of derivatives products. Such investors traditionally provide a valuable counter cyclical role in financial markets due to their long-term investment horizon and relatively low sensitivity to short-term market fluctuations. The concern was expressed that collateral and margin requirements on long-term positions may increase the cyclicality of investment as during periods of turbulence the need for highly liquid collateral will rise that may lead to long-term investors liquidating their long-term holdings to satisfy increased margin and collateral requirements. Because of the increased cost of hedging and concentration of liquidity in standardised contracts, it was suggested that long-term investors may take one of three options with respect to their risk mitigation approaches: undertake less perfect hedging which will lead to greater basis risk (that may in turn have an impact on the accounting treatment of those hedges); second, do not hedge all exposures, which may result in the limit in the third option of a withdrawal from use of hedging products leaving risks unhedged in their entirety. Commercial users at the workshop outlined experience of all three approaches.

Pension fund representatives noted their need to match their long-term liabilities with long-term assets that make long-term project finance an attractive investment for them. They noted that due consideration need to be given to differentiate risk-seeking leveraged financial institutions from non-leveraged ones. Pension funds undertaking long-term investments typically hedge various key elements of long-term exposure such as exchange rate and interest rate risks in order to lower their overall risk profile and meet their risk objectives. Some concerns were expressed as to the additional liquidity pressures associated with such hedging instruments, linked to the regulatory initiatives to provide collateral and margin. Holding a greater collateral and liquidity buffer can be costly in respect of income forgone.

Participants added that this was another aspect of the key question as to who is best suited to hold the risks associated with long-term investments. Before the financial crisis, market risk was generally carried by intermediaries. There are now more pressures to shift the risk from banks to investors/issuers directly.

More broadly, participants noted that OTC derivatives have traditionally provided a hedging mechanism for different exposures present in long-term investment projects. The higher costs of hedging such risks raised challenges for some long-term investors and commercial users that did not have ready access to pools of collateral and liquidity. Exploration of alternative approaches to mitigate such risks would be very helpful to lower the potential disincentives regarding participation in long-term investment.

Session 5 – Accounting policies and long-term investment

Participants described the purpose of published financial statements as being to provide financial information about an entity, consistent with the rules set out in accounting standards, that is intended to provide both stewardship information for investors (i.e. to explain what the directors have done with the shareholders' capital during the year) and cash flow information for creditors and other stakeholders. The intention is to properly communicate economic reality in describing what has happened to the business and to provide consistent and reliable information to the markets.

Participants noted that accounting standards are intended to be neutral in that they do not reward specific behaviours or promote key outcomes. But they do incentivise preparers to manage what they measure, and there is some evidence that this includes short termism (e.g. banks can and do manage assets and liabilities to help achieve leverage ratio targets).

Toll road (service concession) contracts were discussed as an example of how accounting standards measure business activity. Under former standards, it was common for the profits on a long-term road contract to be apportioned on a straight line basis over the life of the contract. This could mean that income was recognised before the road was completed and revenues received. Current standards recognise that cash flows are not linear, and so avoid the danger of creating an accounting subsidy by smoothing away volatility. It is felt to be better for investors to reflect the current state of a contract rather than its long-term profitability.

Participants acknowledged the importance of reflecting the entity's business model in financial statements and avoiding uninformative uniformity. The IASB is working on revisions to its Conceptual Framework that will address this issue, although it is likely to be several years before these revisions are adopted. It was also noted that asset valuation is often entity-specific and that consistency should not necessarily mean uniformity. The Enhanced Disclosure Task Force's Principles and recommendations on risk disclosures may be able to help provide better disclosures.

Accounting volatility was discussed: it was noted that the standard setters more often consider allocation of gains and losses arising from re-measuring financial assets and liabilities to

Other Comprehensive Income (OCI) rather than the income statement, which reduces income statement volatility without affecting the balance sheet. This approach is proposed under the new Insurance Contracts standard (IFRS4) and in the changes on Classification and Measurement under IFRS9. There will also be changes to the hedge accounting rules that may make hedging easier, although the standard is new and untested.

Participants noted the wider implications of the proposed changes to insurance accounting, and the potential for volatility that will be introduced as a result of the use of differing bases for accounting for insurance contracts and related financial assets. There will be a need for more transparency and education to enable users to understand the effects, as well as a need to map capital requirements against the accounting changes. Some participants emphasised the importance of introducing the new accounting standards for financial assets and insurance liabilities at the same time, and allowing flexibility for the accounting valuation bases to be matched.

Session 6 – Innovation in the provision of long-term investment

The final session of the workshop explored recent innovation and adaptation of long-term finance markets, addressing how financial regulation could support innovation and initiatives that could help to meet funding gaps and facilitate the channelling of investor funds to long-term projects via capital markets or direct investments.

Participants noted a number of positive developments. For example, the market for project bonds was growing, and new infrastructure and structured debt funds were being created to meet additional demand. Steps to increase the attractiveness of long-term finance provision to institutional investors were particularly important. That often required additional focus on the risk characteristics of projects and structuring the finance requirement to meet the risk and return characteristics to different types of holders. Greater attention to project preparation (such as greater standardisation of terms and presentation of projects by project sponsors) could also help appraisal by potential investors and lower the barrier to entry to new finance providers.

Speakers welcomed the steps taken by development banks (national, regional and multilateral) to introduce new facilities and instruments that have played a catalytic role in supporting additional investment. A particular aim of a number of these facilities was to provide credit support or enhancement through forms of insurance or risk guarantees that helped to lower the risks to potential holders of senior debt, for example, and thus improve the matching of the risks to risk appetite. Offering partnership with institutional investors could also help to bring in new providers of finance and leverage scarce development bank funds. Other initiatives were targeted at the development of deeper and more liquid capital markets through the issuance of high quality bonds that could act as broader market benchmarks. Increasing the depth and liquidity of markets could be self-reinforcing as new investors were attracted by the terms on offer.

The importance of regulatory predictability and certainty was highlighted as a key factor to support healthy financial innovation and the supply of long-term finance. New instruments were being developed to take account of the changes in market conditions and strengthening of the regulatory framework. Participants again highlighted the case for rapid completion of the reform agenda while paying due account to the points made during the workshop on the impact and incentives of financial regulation on the provision of long-term finance and financial products.

Concluding points

FSB staff thanked participants for their full and active contribution to the Workshop. Staff noted that a summary of the workshop would be provided to participants – any additional observations would be very welcome. The summary of the workshop would be provided for the G20, alongside an assessment of the implications of the workshop for the FSB’s monitoring framework on the effects of financial regulation.