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Financial markets

Commission consults on role of markets in long-term financing

By Manon Malhère | Monday 25 March 2013

Enhancing the role played by financial markets in financing the long-term economy is one of the key elements of a green paper launched by the European Commission on 25 March. This eagerly-awaited document aims to identify all methods of boosting long-term financing. Stakeholders now have until 25 June to give their opinions, and the EU executive will then use the results to define measures to be taken; both legislative and non-legislative.

Until now, the Commission has been concentrating on the reform of the European financial system in order to re-establish stablility, but “it is now time to reflect on a more proactive and dynamic regulation for growth,” said Internal Market Commissioner Michel Barnier.

According to data from the European Commission, in spite of the crisis, ratios of investment or saving in Europe correspond to around 20% of the EU GDP, which the green paper points out is “favourable compared to other regions.” Nonetheless, the current gloomy economic situation has created uncertainty, as well as aversion to risk-taking among savers and investors, who are consequently little inclined to take on long-term investment.

However, Barnier emphasised: “Europe’s economy is facing massive challenges, including large-scale long-term investment needs. These are essential as a basis for innovation and competitiveness, supporting a return to sustainable growth,” he added. With this green paper, the Commission is investigating ways of guiding the European financial system to ensure that supply meets demand.

SOURCES

The first point of reflection is sources of long-term financing, starting with financial markets. Currently, banks finance around 75% of the European economy, whereas in the United States, this financing is mainly drawn from financial markets.

The European economy is too dependent on banks and loans, many observers have commented, adding that financial markets could play a more important role in financing the economy.

The capital market can contribute to the financing of the economy “on the condition that it is better integrated and well regulated,” said Barnier, but he added: “I am not going to set an objective on balancing financing from banks (75%) and financing from the financial markets (25%) - but we could sensibly go beyond 25%”.

While initiatives are already on the table, including the reform on markets in financial instruments, known as MiFID-MiFIR (currently being negotiated), the Commission is also considering new possibilities, including the use of securitisation markets. Securitisation permits banks to sell a portfolio of claims - such as outstanding loans - to an ad hoc company, which will then transform the portfolio into financial securities issued on global markets. However, securitisation financed the subprimes (risky mortgages) market in the United States, which triggered the global financial crisis; therefore, this technique is controversial.

“We think that healthy and responsible securitisation should play a role in financing the European economy in an efficient way,” said a European source. Nonetheless, the EU executive currently has no intention of regulating further in this area - which is already regulated at European level by various different rules. For example, the regulation on prudential banking rules (CRD III) obliges the investor to ensure that the financial institution that is involved in securitisation retains 10% of the risk. The Commission is proposing more support for private initiatives; projects whose goal is to establish secure and transparent securities, subject to supervision. The green paper suggests quality labels distinguishing between high-quality, transparent and standard securities.

ACCOUNTING

The Commission also investigates the most transverse factors impacting the orientation of financing (short/long term). Beyond taxation, accounting standards are also suggested, and the Commission is leaning more specifically towards the controversial ‘fair value’ accounting technique, used in the International Financial Reporting Standards (IFRS), which are applied by the EU.

According to this method, companies listed on the stock exchange attribute values to assets and liabilities on their balance sheets according to market value, not accounting value. Many observers say that this practice - which is too concerned with market volatility - encourages more risk-taking in the short term, but not in the long term.

“In many circumstances, it makes sense to use fair value, because it is accurate and allows for better accounting,” explained one European source. But “is it a tool that facilitates long-term investment?” asked the same source, questioning whether this method should be “systematically” used.

The green paper “asks good questions in the sense that it addresses the bias in certain accounting standards,” Jérôme Haas, president of the Accounting Standards Authority, told *Europolitics.*

Meanwhile, John Davies from ACCA, the Association of Chartered Certified Accountants, said: “Fair value plays an important role in providing updated information - as long as its limits are correctly understood. Nonetheless, it will not always be a relevant measure, in particular for assets that should be used in business rather than sold.”

The green paper is available at www.europolitics.info > Search = 332720