

Financial Regulatory Factors Affecting The Availability of Long-Term Investment Finance

Eric Parrado H.
Chairman
Banking and Financial Institutions Regulation
Authority of Chile

Sixth Meeting of the FSB Regional
Consultative Group for the Americas
Bogota, 6 June 2014

Outline

- Motivation
- Issues for debate regarding the availability of long-term finance
- Financial regulation as a tool to facilitate the channelling of funds

Motivation

- Emerging markets and developing economies (EMDEs) face the dilemma of having an abundance of areas to develop with scarce and volatile capital.
- Output of EMDEs is close to their potential, therefore, only through higher investment rates they can achieve a stronger and sustainable economic growth.
- Latin American economies only invest on average 17% of their gross domestic product, compared to 45% in China.

Motivation

- According to a recent World Economic Forum report, Infrastructure Investment Policy Blueprint, the shortfall in global infrastructure investment is around \$1 trillion per year.
- However, there are several institutional investors that are ideal candidates to provide long-term financing.
- The challenge is to reduce the gap between the need for these projects and capital made available by investors.

Motivation

- Historically, two primary sources of private debt funding have been available for long-term projects: commercial bank debt and capital markets.
- Unfortunately, in EMDEs the financial deepening is limited. Thus, long-term domestic bank financing, corporate bond issuance, securitization and equity markets remain underdeveloped.
- As a result, the domestic financial system has not been an active player in the funding of long-term projects.

Motivation

- International banks have undertaken the bulk of long-term financing, particularly in EMDEs.
- From 1999 to 2009, commercial banks provided an estimated 90% of all private debt, with large banks in developed countries acting as a major source of financing to EMDEs.
- Banks are still expected to provide the majority of long-term finance in the near to medium term.
- However, it is clear that supplementary sources of debt finance need to be fostered, especially those with the capability to provide long term funds (e.g., pension funds, insurance companies, multilateral agencies, and direct foreign investment).

Motivation

- In some EMDEs an important source of funding to finance long-term projects, especially in infrastructure, comes from the government.
- The Chilean experience of funding infrastructure (mainly highways) should be considered as an alternative. In this case, bonds were issued for institutional investors (pension funds and insurance companies), including state guarantees with high-quality ratings.
- However, government spending and/or guarantees cannot support totally the desired level of investments.

Issues for debate regarding the availability of long-term finance

- The global regulatory reforms aims to make the banking system safer addressing many of the flaws that became visible during the crisis.
- Since these reforms, for instance capital adequacy and liquidity standards, it is too early to observe their effects on the provision of long-term finance in most of the EMDEs.
- Nevertheless, FSB members have identified a number of regulations that may affect the long-term finance, which are focused mainly in capital adequacy, deleveraging and liquidity standards.

Financial regulation as a tool to facilitate the channelling of funds

- A tailored implementation of international standards for EMDEs is required to deal with differentiated risk profile compared to developed countries capital market sophistication institutional infrastructure development.
- New regulatory frameworks should be gradually adopted.
- Regulators should support existing and new intermediaries, institutions, and instruments that foster the provision of long-term finance.

Financial regulation as a tool to facilitate the channelling of funds

- Chilean supervisory authorities plan to implement Basel III regulatory reforms and consolidated supervision of financial conglomerates seeking to ensure that its prudential frameworks are consistent with global standards.
- Also, a desired goal is to continue deepening the capital market, in order to have more tools that enable increased funding for long-term projects.

Financial Regulatory Factors Affecting The Availability Of Long-Term Investment Finance

Eric Parrado H.
Chairman
Banking and Financial Institutions Regulation
Authority of Chile

Sixth Meeting of the FSB Regional
Consultative Group for the Americas
Bogota, 6 June 2014