World Academy of Science, Engineering and Technology International Journal of Economics and Management Engineering Vol:10, No:03, 2016

Accounting and Prudential Standards of Banks and Insurance Companies in EU: What Stakes for Long Term Investment?

Authors: Sandra Rigot, Samira Demaria, Frederic Lemaire

Abstract: The starting point of this research is the contemporary capitalist paradox: there is a real scarcity of long term investment despite the boom of potential long term investors. This gap represents a major challenge: there are important needs for long term financing in developed and emerging countries in strategic sectors such as energy, transport infrastructure, information and communication networks. Moreover, the recent financial and sovereign debt crises, which have respectively reduced the ability of financial banking intermediaries and governments to provide long term financing, questions the identity of the actors able to provide long term financing, their methods of financing and the most appropriate forms of intermediation. The issue of long term financing is deemed to be very important by the EU Commission, as it issued a 2013 Green Paper (GP) on long-term financing of the EU economy. Among other topics, the paper discusses the impact of the recent regulatory reforms on long-term investment, both in terms of accounting (in particular fair value) and prudential standards for banks. For banks, prudential and accounting standards are also crucial. Fair value is indeed well adapted to the trading book in a short term view, but this method hardly suits for a medium and long term portfolio. Banks' ability to finance the economy and long term projects depends on their ability to distribute credit and the way credit is valued (fair value or amortised cost) leads to different banking strategies. Furthermore, in the banking industry, accounting standards are directly connected to the prudential standards, as the regulatory requirements of Basel III use accounting figures with prudential filter to define the needs for capital and to compute regulatory ratios. The objective of these regulatory requirements is to prevent insolvency and financial instability. In the same time, they can represent regulatory constraints to long term investing. The balance between financial stability and the need to stimulate long term financing is a key question raised by the EU GP. Does fair value accounting contributes to short-termism in the investment behaviour? Should prudential rules be "appropriately calibrated" and "progressively implemented" not to prevent banks from providing long-term financing? These issues raised by the EU GP lead us to question to what extent the main regulatory requirements incite or constrain banks to finance long term projects. To that purpose, we study the 292 responses received by the EU Commission during the public consultation. We analyze these contributions focusing on particular questions related to fair value accounting and prudential norms. We conduct a two stage content analysis of the responses. First, we proceed to a qualitative coding to identify arguments of respondents and subsequently we run a quantitative coding in order to conduct statistical analyses. This paper provides a better understanding of the position that a large panel of European stakeholders have on these issues. Moreover, it adds to the debate on fair value accounting and its effects on prudential requirements for banks. This analysis allows us to identify some short term bias in banking regulation.

Keywords: basel 3, fair value, securitization, long term investment, banks, insurers

Conference Title: ICBFE 2016: International Conference on Business, Finance and Economics

Conference Location : Miami, United States **Conference Dates :** March 24-25, 2016