FSB FINANCIAL STABILITY BOARD

20 November 2018

Evaluation of the effects of financial regulatory reforms on infrastructure finance

Overview of responses to the consultation

Introduction

On 18 July 2018, the FSB published a consultative document on the *Evaluation of the effects of financial regulatory reforms on infrastructure finance*. The FSB received 13 responses to the public consultation from banks, insurers, development banks and industry associations.[1]

Respondents generally welcomed the consultative document, noting the importance of this evaluation given the contribution of infrastructure finance (IF) to economic growth. This note summarises the comments raised in the public consultation and sets out the main changes that have been made to the evaluation report in order to address them.

Summary of main issues

Respondents noted that the report provides a generally accurate and comprehensive description of the characteristics and main IF trends and drivers; covers the most relevant G20 reforms (i.e. the Basel III capital and liquidity requirements and over-the-counter (OTC) derivatives reforms); and appropriately evaluates the effects of those reforms that have been implemented to date using empirical techniques. Some of the respondents suggested expanding the analysis on reforms that are being phased in or have not yet been implemented, or encouraged more work on policies to promote IF more broadly. Below are the main issues raised by respondents.

Relevant reforms other than Basel III and OTC derivatives

Comments: Some respondents suggested that revisions to accounting standards and national/regional insurance reforms (e.g. Solvency II) should feature more prominently in the report given their perceived importance.

Changes in response to the comments

Implementation of new accounting standards is at an early stage, with the bulk of changes only coming into effect in future years, and affected institutions may have a range of behavioural responses. Extensive analysis of regional insurance regulation would go beyond the scope of the evaluation, which is focused on G20 reforms. However, more details on these reforms and their potential effects have been added to section 4 of the report and the corresponding Annexes.

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[1] The comment letters are published on the FSB's website: http://www.fsb.org/2018/09/public-responses-to-the-consultative-document-of-the-evaluation-on-the-effects-of-financial-regulatory-reforms-on-infrastructure-finance/.

Methodology

Comments: One respondent noted that the data does not cover a sufficiently long time span to properly assess the steady state effects of reforms, while another suggested looking at the cumulative effect of transmission channels from regulation but did not provide details. A few respondents acknowledged the distinction made in the report between Advanced Economies (AEs) and Emerging Market and Developing Economies (EMDEs), but felt that more emphasis should be placed on analysing effects across individual countries.[2]

Changes in response to the comments

The caveats to the analysis – in terms of data limitations and conceptual challenges – are already highlighted in sections 1.3 and 4.1 and described in detail in Annex C. Some text has been added to section 4 to highlight these caveats more prominently. Some of the cumulative effects of the reforms are captured in the empirical analysis (e.g. global systemically important bank (G-SIB) regulations, IF vs other types of finance, banks vs non-banks) for the most important reform elements, and they do not indicate a substantial impact on the provision of IF. The evaluation also included analysis of trends and extensive consultation with market participants – an industry workshop, a qualitative survey and targeted interviews – that provided a fairly consistent overall picture on the effects and confirmed that the results of the empirical analysis hold at the aggregate level. Graph 9 also shows, from a conceptual perspective, how regulatory transmission channels may interact at the aggregate level.

The empirical analysis has taken into account some country specificities: (a) there are controls for country-specific effects (via fixed effects) and other relevant market segments (industry sectors, financing instruments, financing types); and (b) variation in implementation timelines has been considered and found to be fairly limited for Basel III, but was taken into account for OTC derivatives reforms. While differences in the domestic application of G20 reforms were not analysed separately, such differences are unlikely to be material enough to differentiate between potential effects given available evidence. The analysis of effects focuses on financing providers at the consolidated level, since this will usually determine the regulatory approach for a group and its foreign subsidiaries. Notwithstanding this, the description of country-specific drivers has been expanded in section 4.2 and more country-specific descriptive statistics have been provided in Annex A.

Effects of forthcoming G20 reforms

Comments: Some respondents argue that the evaluation does not fully address effects since it does not sufficiently take into account forthcoming reforms – especially the Basel III reforms finalised in December 2017 – that, in their view, could have a substantial impact on IF. These respondents call for a revision to the conclusion that the impact of regulatory reforms on IF is secondary to other issues or a caveat that the conclusion may change once these reforms are implemented; a reconsideration of the calibration of the finalised Basel III reforms; and a follow-up round of evaluation.

Changes in response to the comments

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2 These respondents cited country-specific factors such as public infrastructure policies and fiscal position; differences in domestic implementation of reforms in terms of timelines and content; legal characteristics; technical know-how to execute complex structures; availability of financing in the relevant currency; and political and regulatory risk.

As noted in the introduction to the report (section 1), this is among the first evaluations under the July 2017 FSB *Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*. The focus of the framework is on post-implementation evaluation; that is, evaluating the effects of reforms for which implementation is well underway or completed.[3] Nevertheless, the evaluation describes other reforms that may be relevant for IF and their potential transmission channels (mostly in Annex B), while generally not seeking to quantify their impact given that their implementation is at an early stage. It should be noted that the Basel Committee has undertaken a cumulative ex ante Quantitative Impact Study (QIS) while developing the finalised Basel III reforms and intends to monitor their implementation and assess their impact.[4]

The Executive Summary of the report has been revised to explain more clearly the scope of the exercise agreed by FSB members and the fact that the empirical analysis has necessarily focused on the effects of those reforms for which implementation is well underway or completed, while other reforms have been considered qualitatively. The illustrative impact of changes to the Basel III risk-weighted capital framework in Box 3 and Annex E has also been made more granular to reflect the respondents' feedback about considering the Loss Given Default (LGD) input floor under the Advanced Internal Ratings-Based approach.

However, no references to a follow-up evaluation have been added. The FSB evaluation framework states that the selection and prioritisation of topics for future evaluations (including on IF) will be taken by the FSB on the basis of assessments of materiality and feasibility, after consultation with the relevant standard-setting bodies (SSBs).

Other issues

Comments: Some respondents suggested that the evaluation includes recommendations on the calibration of the IAIS Insurance Capital Standard (ICS) for infrastructure investments, and on other policies to promote IF given the G20 priority in this area. With respect to the former, one respondent encouraged stronger statements from the FSB in its conclusions relating to the need for international SSBs – when designing new standards or reviewing existing standards – to have regard to the G20's commitments to support growth and the role of IF in this respect. With respect to the latter, two respondents proposed additional work on improving capital market access for investors in infrastructure projects, such as on the pooling of projects and securitisation, and the standardisation of financial documentation and disclosure requirements.

Changes in response to the comments

The report notes that the objective of the evaluation is to assess the effects of financial reforms on IF, complementing work under the Argentine G20 Presidency to develop infrastructure as an asset class. The conclusions reached in the evaluation do not preclude SSBs from continuing to assess the extent to which their standards are adequately calibrated to the particular

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[3] The evaluation framework further states that "The framework will cover ex ante analysis only to the extent that it is necessary for post implementation evaluation, such as translating policy objectives, set out at the time of development, into observable and measurable outcomes, and comparing available ex ante impact assessments with realised outcomes."

[4] The BCBS has developed a work programme to evaluate the effectiveness of individual standards, the interactions and coherence among standards, and the broader macroeconomic impact of the post-crisis BCBS reforms. The BCBS will also continue to monitor the quantitative impact of Basel III reforms. The latest *Basel III Monitoring Report* was published in October 2018.

characteristics and risks of IF. However, the feasibility and desirability of a different regulatory calibration across sectors depends on a variety of factors (e.g. definitions, data, balance between complexity and risk-sensitivity) that go beyond the scope of the evaluation.

Moreover, as noted in the FSB evaluation framework, the results of evaluations will not contain any specific policy recommendations, but rather findings for consideration by the appropriate bodies. The final responsibility for deciding whether and how to amend a particular standard or policy remains with the body that is responsible for issuing that standard or policy. The IAIS is currently working on the calibration of the ICS for internationally active insurance groups, including with respect to the treatment of infrastructure investments.[5]

Similarly, an analysis of solutions to improve capital market access is beyond the scope of the evaluation and would duplicate work being carried out elsewhere. To clarify the nature of this work and put the evaluation in a broader context, a Box has been added in section 1 to describe the actions being undertaken by the G20 in this area.

Other comments on specific issues

Comments: There were also suggestions by some respondents to add more details on: the factors that determine market participants' decision to engage in IF; the search for yield as an important driver of institutional investor interest in IF; the limited supply of bankable infrastructure projects; and the role of currency mismatches and the availability and cost of hedging instruments. On the latter, several respondents suggested that these factors, while important, were driven by structural market issues rather than regulatory developments and had not changed significantly in recent years.

Changes in response to the comments

The final report contains minor amendments to reflect these points.

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5 The IAIS issued ICS 2.0 for public consultation until October 2018. The consultation asked respondents for views on the appropriate calibrations for infrastructure investments, and on a possible segmentation and definitions for various types of infrastructure investment. Once the ICS is approved by the IAIS, it will enter the five year monitoring period during which further work on fine-tuning the standard will be undertaken by the IAIS and the relevant insurance supervisors.