



Since it does not take the investment horizon into consideration, the accounting and prudential treatment of financial assets giving priority to their marked to market value is standing in the way of long-term investment. This class of investment offers the benefit of ensuring a stable financial presence

within businesses or infrastructure projects. It also represents the appropriate counterpart to long tail insurance risks and to pension liabilities.

This situation is resulting in financial communications that are not particularly legible. Indeed, due to the mark to market rule, the contingencies affecting the value of these investments over the short term are having repercussions over time on the financial statements - higher earnings volatility and additional solvency requirements -, although the actual horizon for these investments goes beyond that for the publication of the accounts. In light of this upheaval, certain long-term investors are adopting behaviours that go against their specific characteristics, such as selling off positions when the markets fall. Moreover other financial players may reduce in such context their long term liabilities. At the same time, these regulations do not factor in the stability of the liabilities at all, or only slightly, whereas it would be wise to encourage investors to have stable resources, guaranteeing protection against forced sale practices, notably when principals push for assets to be realised early, which would be more damaging over the long term than the gain taken out over the short term.

These situations can be seen whatever the nature of the institution carrying this type of investment: insurance firms, banks, pension funds, sovereign funds or hedge funds. They primarily reveal the inability of current financial regulations to take into consideration the fact that an asset's immediate value may be substantially different from its long-term value as a result of the ability of economies to overcome their temporary difficulties and continue growing in the long run.

To achieve this goal, it would first of all be necessary for the accounting rules to be adapted in order to make it possible to value a long-term investment based on a weighting for its market value, while also taking into account the value of its future cash flow over the long term.

Furthermore, specific prudential rules should guarantee that the liabilities will be honoured when they reach maturity and also that the long investment horizon is suitably protected against the various contingencies linked to the liabilities: massive unexpected withdrawals, drying up of sources of financing on the relevant maturities, etc. More generally, these prudential rules should protect such assets against the possible consequences of any difficulties affecting the short-term activities also carried out by the financial institution.

At the same time, governance rules should ensure that dedicated decision-making processes are put in place for long-term investments, protecting them against short-term influences, whether they come from management or shareholders. Lastly, the practices adopted, particularly by issuers, should promote the emergence of specific returns and vehicles to build loyalty among investors.

The current financial crisis illustrates the need for the stabilising role played by long-term investment. The institutions in charge of accounting and prudential legislation and standards at European and if possible global levels must therefore, alongside their actions on accounting and prudential standards for short and medium-term financial activities, recognise that long-term investment represents a specific investment logic and set about defining a suitable regulatory framework accordingly.

Such initiatives are also needed to accompany the efforts made by public authorities to support this type of investment, reflected for instance in the promotion of share-based investments among citizens or even tax incentives for retirement savings.

More generally, long-term investor activities should be clearly differentiated from other shorter term banking and financial activities. Lastly, long-term investor activities should be regulated and supervised by a dedicated regulatory and supervisory framework.

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<sup>1</sup> This Eurofi paper do not engage the Chairmen of Eurofi