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News release

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Taking the long view: how market-based finance can support stability - speech by Dame Clara Furse

In a speech to the Chartered Institute for Securities and Investment on Friday, Dame Clara Furse talks about the importance of the FPC's forward agenda for the next 12-18 months, in particular, its work to improve the diversity of market-based financing in the UK.

Dame Clara explains that the FPC's work so far has, rightly, focussed on mitigating systemic risks to the UK financial system by improving the resilience of banks. While economic growth reflects an improvement in confidence, some market segments, including SMEs, have continued to face tight credit conditions. Improving the availability of non-bank and market-based finance can help to broaden the type of funding available to companies.

She states that the FPC will work with the wider Bank to examine the impediments to the development of market-based finance in the UK. As part of this work, it will assess and, where necessary, act to:

- promote a better functioning securitisation market in the United Kingdom;
- consider whether a credit register might support financial stability;
- enhance the resilience of liquidity in those financial markets important to our financial resilience; and
- reduce the risks to the system arising from procyclicality in the availability of finance, including via collateral markets.

"This targeted approach to market-based finance is timely, sensible, proportionate and constructive. By identifying actions that support greater diversity in the financial system, the FPC can enhance the system's overall resilience (its primary objective) and create the conditions for sustainable economic growth (part of its secondary objective)."

Of particular importance to Dame Clara, is that the financial system is able to provide credible long-term equity capital to promising companies to support innovation and future economic growth.

"In my view, long-term private sector investment, particularly in infrastructure and SMEs, is fundamental to our economic future; this was also highlighted by the G20 in its February communique. In particular, I would like to try to ensure that necessary mechanisms operating in the financial system to address specific risks do not, when taken as a whole, unduly damage the ability or willingness of investors to provide committed long-term equity funding."

Dame Clara highlights four impediments to the availability of long-term equity finance: short-termism, driven, for example, by the use of mark-to-market accounting in sectors such as life insurance; the trend towards liability-driven investment among institutional investors, which, though in some circumstances rational, has been defensive and has probably put steady upward pressure on the cost of equity; non-bank financial investors who finance long-term "illiquid" assets with short-term liabilities, which may encourage investors with similar exposures to hold more short-term low-volatility liquid assets. Finally, Clara cites the powerful asymmetry in the UK in the tax treatment of debt and equity as providing a long-standing structural incentive to fund businesses with debt rather than equity.

"My concern is that frictions such as these could mean that the 'low for long' market interest rate environment is masking an underlying weakness in investor appetite for equity. For example, despite the widely-reported search for yield, equity risk premia remain above their long-run averages in the UK, US and euro area, as evidenced by secondary market pricing."

Dame Clara also points out that regulation is vital in promoting confidence by building a framework with predictable and proportionate rules, standards and reactions, but that businesses and investors must also play a part in developing high standards of corporate governance and building trust.

"It is vital that those invested in our financial future engage actively with regulators in shaping the boards and business models that they believe will build a safer financial system, equipped to finance and support broad-based UK economic growth in an ever expanding global market."