

FSB

FINANCIAL
STABILITY
BOARD

Shadow Banking

Financial Stability Board (FSB) and its work on
Shadow Banking

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Overview of the Financial Stability Board (FSB)

Established: April 2009

Chairperson: Governor Mark Carney (Bank of Canada)

Vice Chair: Philipp Hildebrand (Swiss National Bank)

Membership: Authorities responsible for financial stability (ie treasuries, central banks and financial supervisory agencies) of 24 jurisdictions

+

International standard setting bodies, IFIs and central bank committees related to market infrastructure

Location: FSB Secretariat is hosted by the Bank for International Settlements (BIS) in Basel, Switzerland.



Mandate of the Financial Stability Board (FSB)

- Assess vulnerabilities affecting the financial system and identify and oversee action needed to address them;
- Promote coordination and information exchange among authorities responsible for financial stability;
- Monitor and advise on market developments and their implications for regulatory policy;
- Advise on and monitor best practice in meeting regulatory standards;
- Undertake joint strategic reviews of the policy development work of the international standard setting bodies to ensure their work is timely, coordinated, focused on priorities, and addressing gaps;
- Set guidelines for and support the establishment of supervisory colleges;
- Manage contingency planning for cross-border crisis management, particularly with respect to systemically important firms; and
- Collaborate with the IMF to conduct Early Warning Exercises.

The FSB's financial reform agenda in 2010-11

- Implementation of reforms to bank capital and liquidity standards (Basel II/III);
- Addressing systemically important financial institutions (SIFIs);
 - Global SIFI (G-SIFI) determination and loss absorbency
 - Resolution tools and regimes
 - Supervisory intensity and effectiveness
- **Strengthening the regulation and oversight of the shadow banking system;**
- Improving the OTC and commodities derivatives markets;
- Developing macroprudential frameworks and tools;
- Convergence on the strengthened accounting standards;
- Strengthening adherence to international supervisory and regulatory standards;
- Reforming compensation practices to support financial stability;
- Financial stability and regulatory issues in emerging and developing countries
- Enhancing consumer protection etc.

30. Bank-like activities. The shadow banking system can create opportunities for regulatory arbitrage and cause the build-up of systemic risk outside the regulated banking sector. To this end, we agree to strengthen the regulation and oversight of the shadow banking system and endorse the FSB initial eleven recommendations with a work-plan to further develop them in the course of 2012, building on a balanced approach between indirect regulation of shadow banking through banks and direct regulation of shadow banking activities, including money markets funds, securitization, securities lending and repo activities, and other shadow banking entities. We ask Finance Ministers and Central Bank Governors to review the progress made in this area at their April meeting.

Why now the shadow banking system? (1)

The Crisis intensified in the non-banking sector...

June 2007 Bear Stearns hedge funds

Autumn 2007 – Mid 2008

Liquidity and solvency problems at off-balance sheet vehicles (eg SIVs, ABCP conduits)

March 2008 Bear Stearns

Summer 2008 Stresses at Money Market Mutual Funds (MMMFs) – Reserve Primary Fund “breaks the buck”

August – October 2008

Liquidity run in repo and other secured funding markets

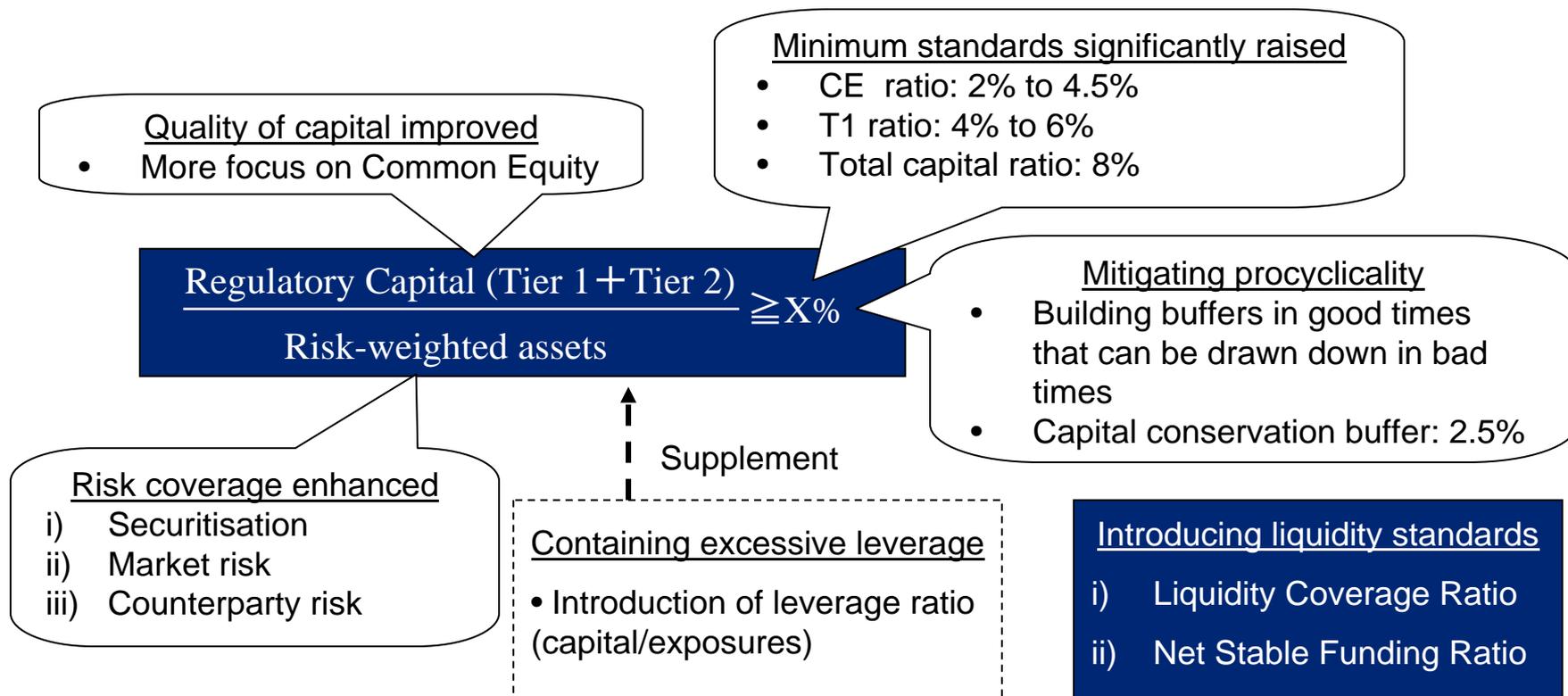
September 2008 Failure of Lehman

Late autumn 2008

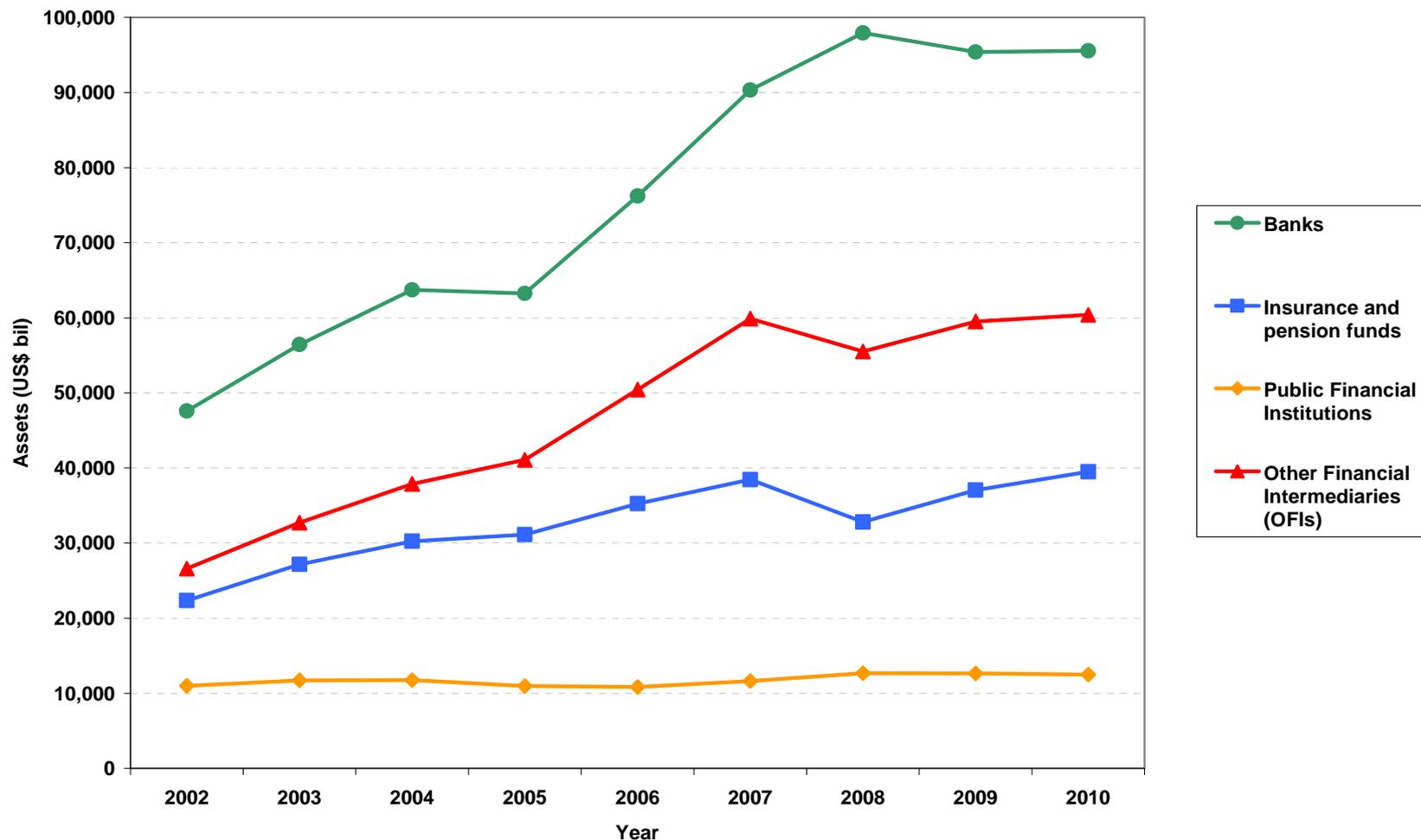
The financial system deleveraging and asset sales exacerbate downward spiral of asset values

Why now the shadow banking system? (2)

Enhancement of Bank Regulatory Capital Framework after the Crisis (Basel III)

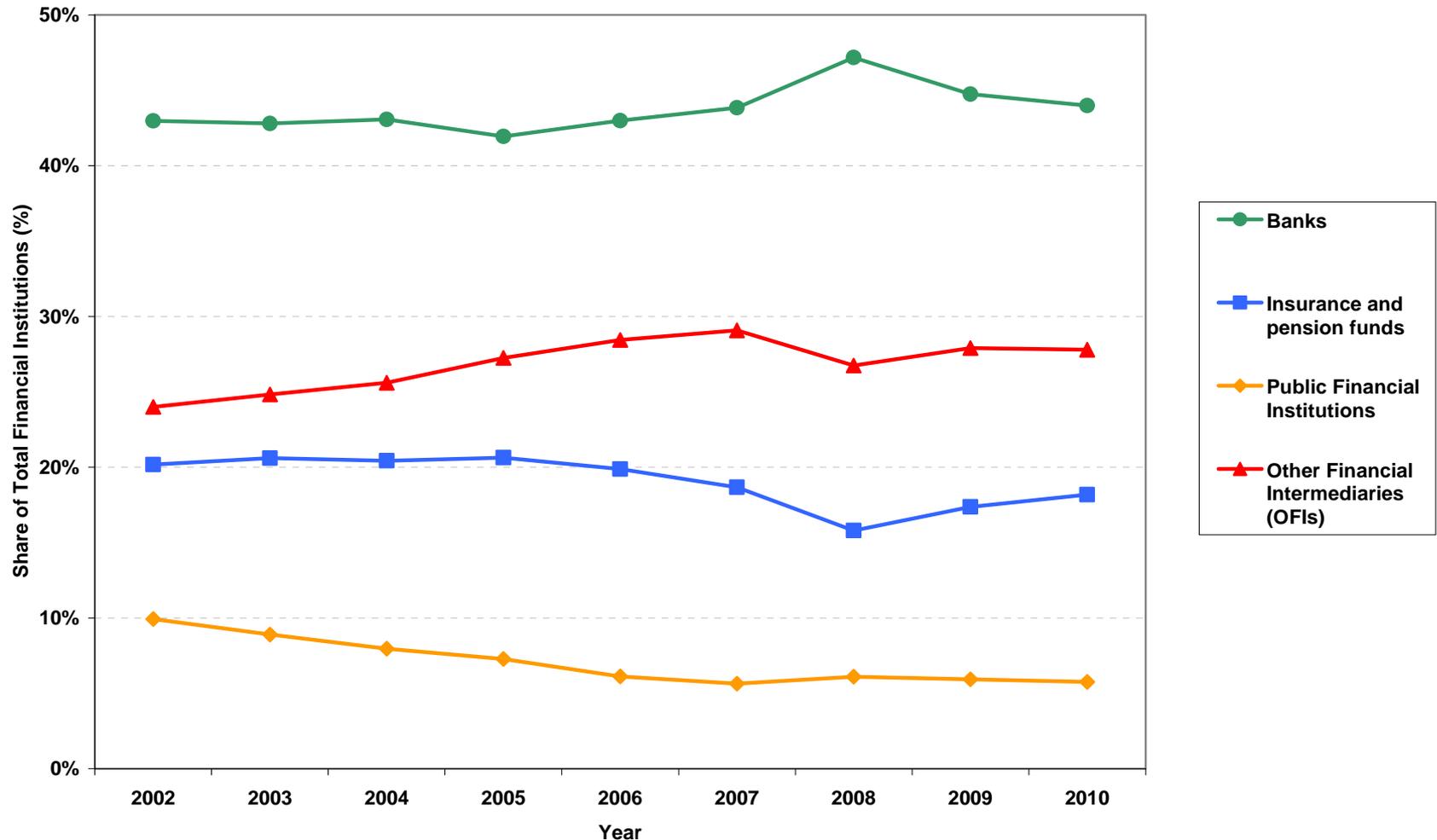


Why now the shadow banking system? (3): the Global Shadow Banking System



Note: Data from Australia, Canada, the euro area, Japan, Korea, the UK and US.
Source: *Shadow Banking: Strengthening Oversight and Regulation*

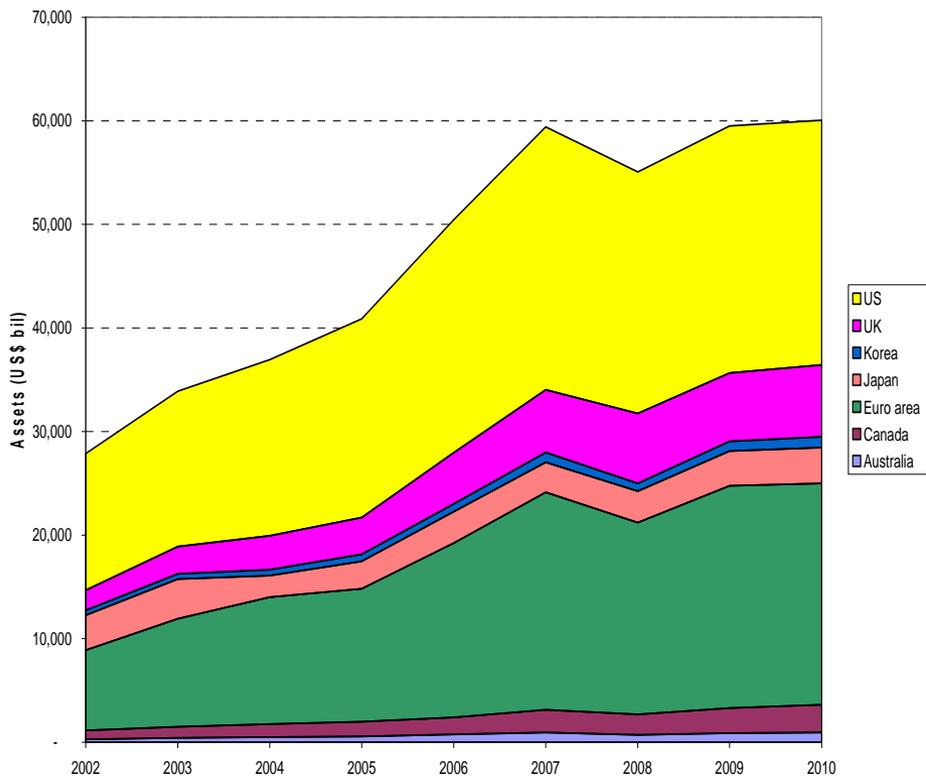
Why now the shadow banking system? (4): the Global Shadow Banking System



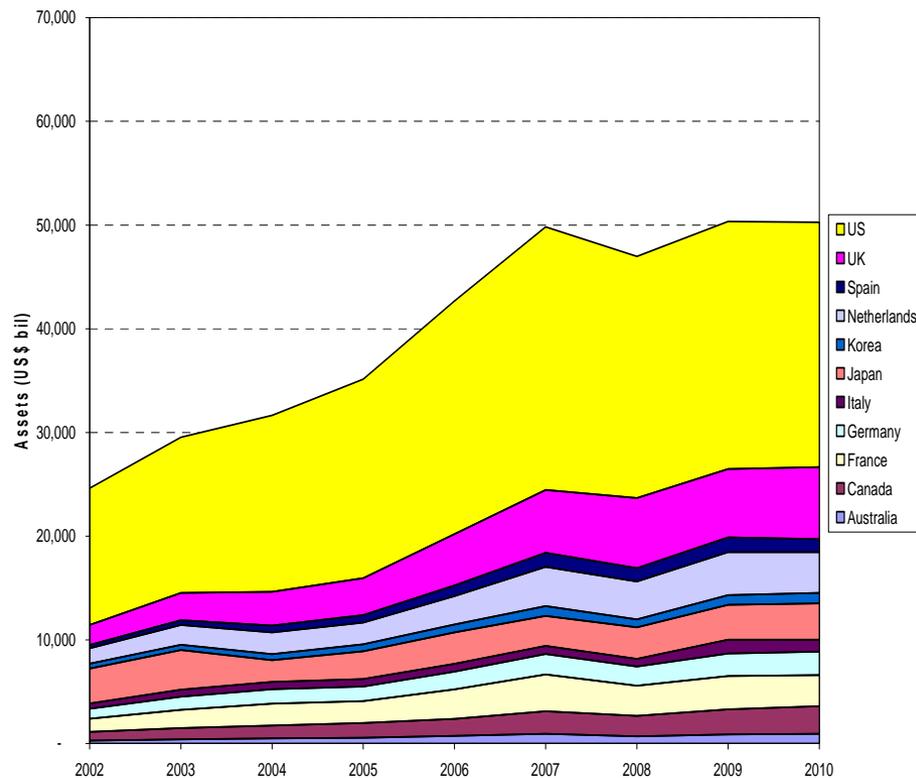
Note: Data from Australia, Canada, the euro area, Japan, Korea, the UK and US.
Source: *Shadow Banking: Strengthening Oversight and Regulation*

Why now the shadow banking system? (5): the Global Shadow Banking System

6 Jurisdictions + the euro area

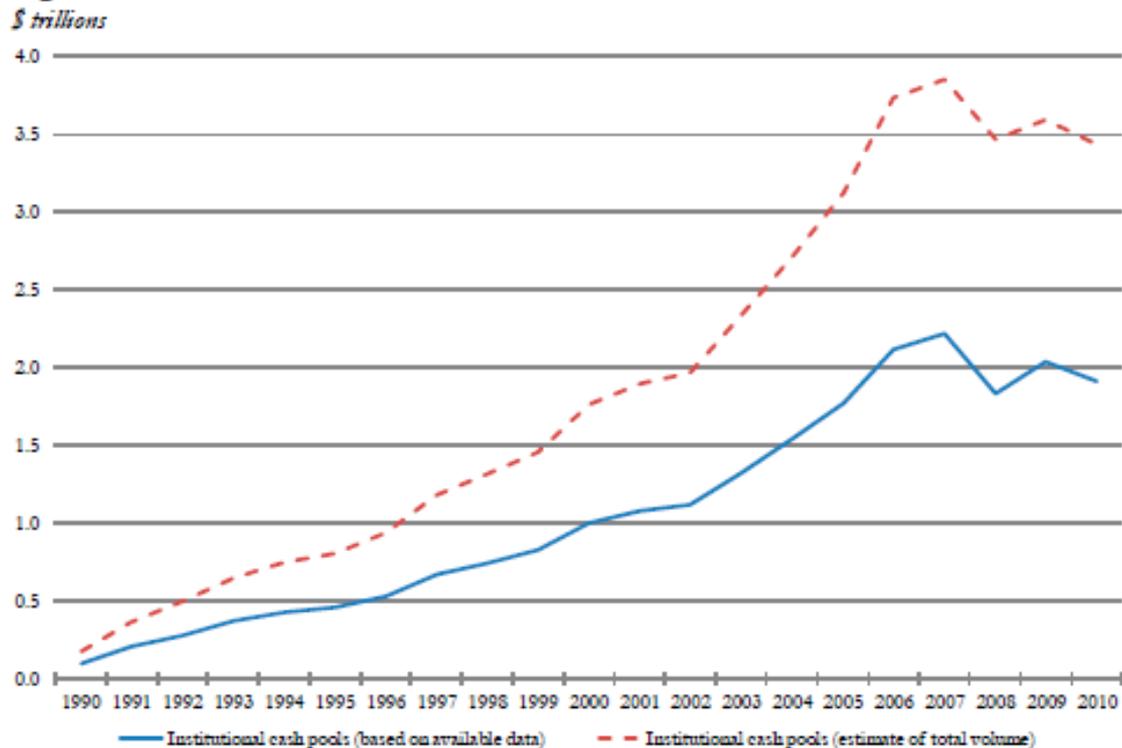


11 Jurisdictions



Why now the shadow banking system? (6)

Figure 1: The Secular Rise of Institutional Cash Pools



FSB work on shadow banking

November 2010 G20 Seoul Summit

“we called on the FSB to work in collaboration with other international standard setting bodies to develop recommendations to strengthen the regulation and oversight of the shadow banking system by mid-2011.”



December 2010 FSB Experts Workshop at UKFSA

January 2011 Establishment of the Shadow Banking Task Force (Co-Chair: Adair Turner (UKFSA) and Jaime Caruana (BIS))

- Clarify what is meant by “the shadow banking system”;
- Set out potential approaches for monitoring the shadow banking system; and
- Explore possible regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking system.

July 2011 Initial recommendations discussed at the FSB Plenary

Summer 2011 Data sharing exercise

October 2011 Submission of the recommendations to the G20 (publication 27 Oct.)

What will be the focus?

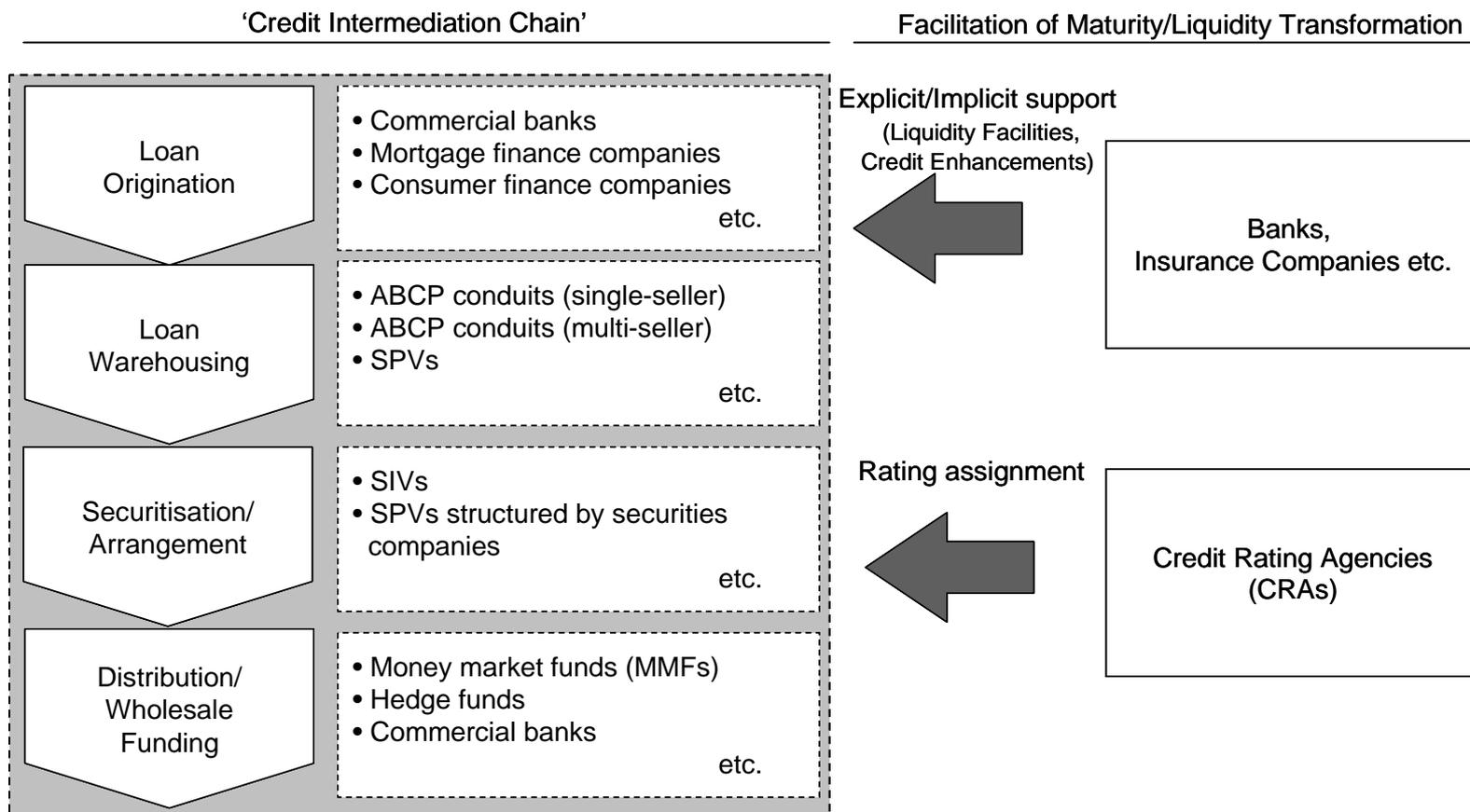
FSB Background Note “*Shadow Banking: Scoping the Issues*” (12 April 2011)

Monitoring and policy responses be guided by a two-step approach:

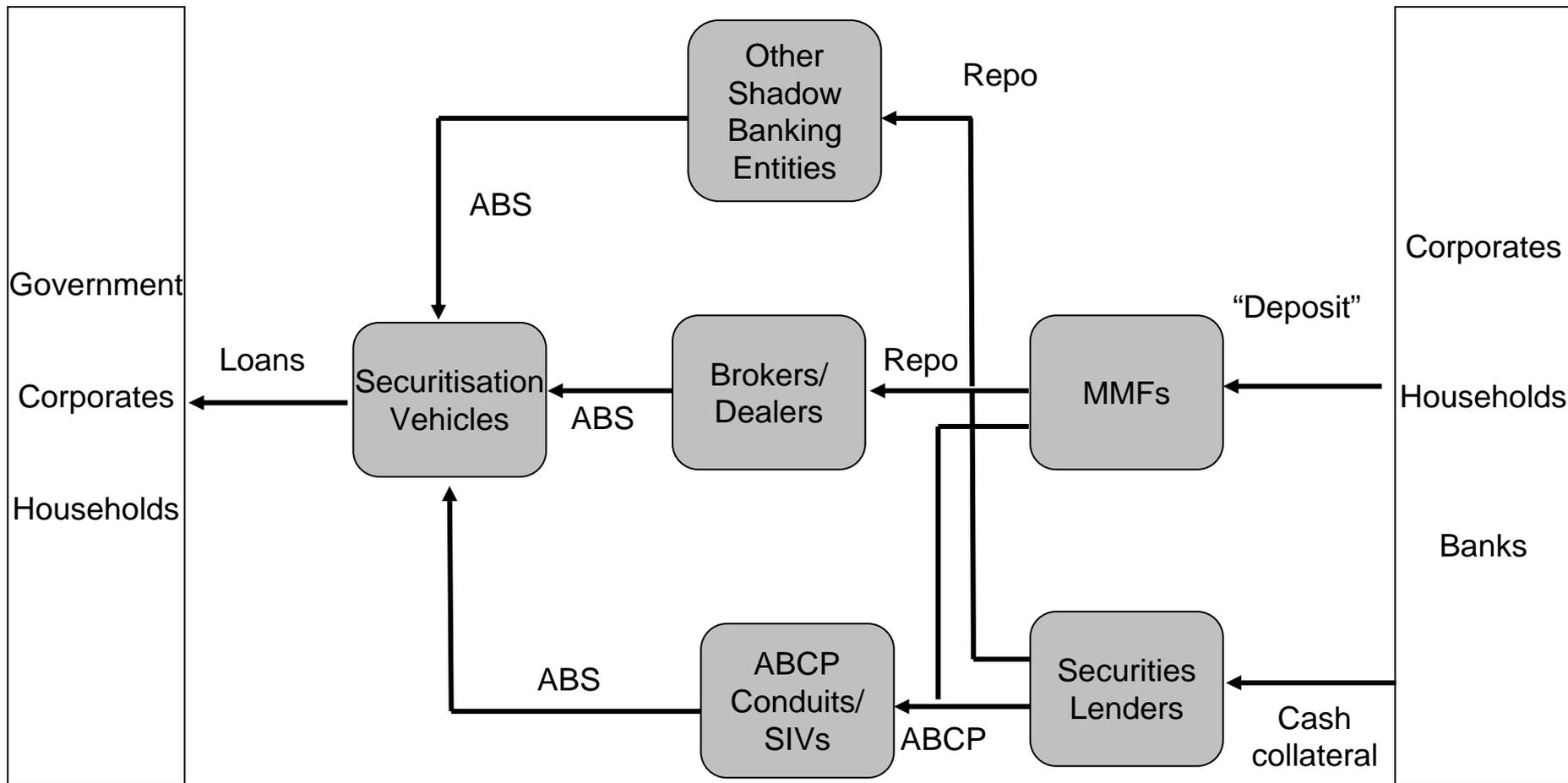
- Firstly, authorities should cast the net wide, looking at all non-bank credit intermediation to ensure that data gathering and surveillance cover all the activities within which shadow banking-related risks might arise.
- Secondly, authorities should then narrow the focus, concentrating on the subset of non-bank credit intermediation - a system of credit intermediation that involves entities and activities outside the regular banking system, and raises concerns by:
 - Maturity transformation
 - Liquidity transformation
 - Imperfect credit risk transfer
 - Leverage
 - Regulatory arbitrage

The structure of the shadow banking system (1)

Shadow banking can be composed of a single entity or involve multiple entities forming a chain of credit intermediation.



The structure of the shadow banking system (2)



Monitoring the shadow banking system (1): High-level principles for effective monitoring

Recommendations for effective monitoring framework will consists of i) high-level principles (outlined below) and ii) a stylised 3-step monitoring process.

- i. **Scope:** Authorities should have an appropriate system-wide oversight framework in place to gain a comprehensive picture of the shadow banking system and of the risks that it poses to the entire financial system.
- ii. **Process:** A monitoring framework for the shadow banking system should identify and assess the risks on a regular and continuous basis.
- iii. **Data/Information:** In establishing a monitoring framework for the shadow banking system, the relevant authorities should have powers to collect all necessary data and information, as well as the ability to define the regulatory perimeter for reporting.
- iv. **Innovation/Mutation:** Monitoring of the shadow banking system should be flexible and adaptable to capture innovations and mutations in the financial system which could lead to emerging risks.
- v. **Regulatory arbitrage:** In monitoring the shadow banking system, authorities need to be mindful of the incentives to expand shadow banking created by changes in regulations.
- vi. **Jurisdiction-specific features:** In developing a monitoring framework, authorities should take into account the structure of financial markets and regulatory frameworks within the jurisdiction.
- vii. **Information exchange:** Authorities should exchange appropriate information both within and across the relevant jurisdictions on a regular basis to be able to assess the risks posed by the shadow banking system.

Monitoring the shadow banking system (2): A stylised monitoring process

Step 1: Scanning and mapping of the overall shadow banking system

- Macro-mapping exercise based on the Flow of Funds (FoF) data to scan and map the scale as well as the key trends in non-bank credit intermediation.
- Information drawn from monetary statistics and supervisory data can complement the macro-mapping.

Step 2: Identification of the aspects of the shadow banking system posing systemic risk or regulatory arbitrage concerns

- Drilling down further to identify key risks by focusing on non-bank credit intermediation that involves (i) maturity transformation, (ii) liquidity transformation, (iii) credit risk transfer, and/or (iv) some degree of leverage.
- Identification of credit intermediation “chain” is important.

Step 3: Detailed assessment of the shadow banking system raising systemic risk or regulatory arbitrage concerns

- Further deepening of the analysis to focus on particular entities, markets and instruments that are giving rise to policy concerns (degree of potential impact that their failure would pose to the system).

Monitoring the shadow banking system (3): Regular data collection and assessment by FSB

The FSB will continue its **annual monitoring exercise for assessing global trends and risks in shadow banking** through its Standing Committee on Assessment of Vulnerabilities (SCAV).

Draft Template Table for Shadow Banking Data Exercise - Flow of Funds*

| Year/Quarterly (as of end-year/Q) for stock assets data | Financial Institutions | Central Bank | Deposit-Taking Institutions | Banks | | | | | | Insurance Companies (Note 2, 3) | Pension Funds (Note 2, 3) | Public Financial Institutions | Public Financial Institutions (Note 4) | XX (Note 1, 4) | Others | Other Financial Intermediaries (OFIs) | Money Market Funds (MMFs) - of which constant NAV or equivalent (Note 5) | Other Money Market Funds (MMFs) (Note 5) | Finance Companies | Structured Finance Vehicles | Hedge Funds (Note 6) | Other Investment Funds (Note 6) | XX (Note 1) | XX (Note 1) | XX (Note 1) | Others | |
|---|------------------------|--------------|-----------------------------|----------------|---------------------|-------------|----------------|---------------------|--------|---------------------------------|---------------------------|-------------------------------|--|----------------|--------|---------------------------------------|--|--|-------------------|-----------------------------|----------------------|---------------------------------|-------------|-------------|-------------|--------|----------------|
| | | | | Assets to OFIs | Liabilities to OFIs | XX (Note 1) | Assets to OFIs | Liabilities to OFIs | Others | | | | | | | | | | | | | | | | | | Assets to OFIs |
| 1999 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2000 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2001 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2002 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2003 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2004 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2005 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2006 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2007 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2008 | 0 | | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2009 | 1Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| | 2Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| | 3Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| | 4Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| 2010 | 1Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| | 2Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| | 3Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| | 4Q | 0 | 0 | | | | | | | | 0 | | | | 0 | | | | | | | | | | | | |
| Note (Detailed definition etc.) | | | | | | | | | | | | | | | | | | | | | | | | | | | |

*: Members may complement the Flow of Funds data with other information. If data is unavailable, please fill in "N/A" or keep it blank.
 Note 1: For XX, please fill in subcategories as relevant.
 Note 2: If data for Insurance Companies and Pension Funds can not be separated, please fill the aggregated number in the insurance companies' cells and explain that in the Note cell.
 Note 3: If data for Insurance Companies, Pension Funds and Public Financial Institutions are included in Other Financial Intermediaries, please clarify that in the Note cell.
 Note 4: If data for government-owned deposit-taking institutions are included in the Public Financial Institutions, please separate that out in XX cells or clarify as such in the Note cell.
 Note 5: If data for MMFs can not be separated between CNAV and Others, please fill the aggregated number in the CNAV MMF cells and explain that in the Note cell.
 Note 6: If data for hedge funds can not be separated from Other Investment Funds, please fill the aggregated number in the Other Investment Funds cells and explain that in the Note cell.

Possible regulation of the shadow banking system (1): Regulatory mapping

The Shadow Banking Task Force has conducted a regulatory mapping exercise to take stock of existing national/international initiatives on the four broad categories of potential regulatory responses:

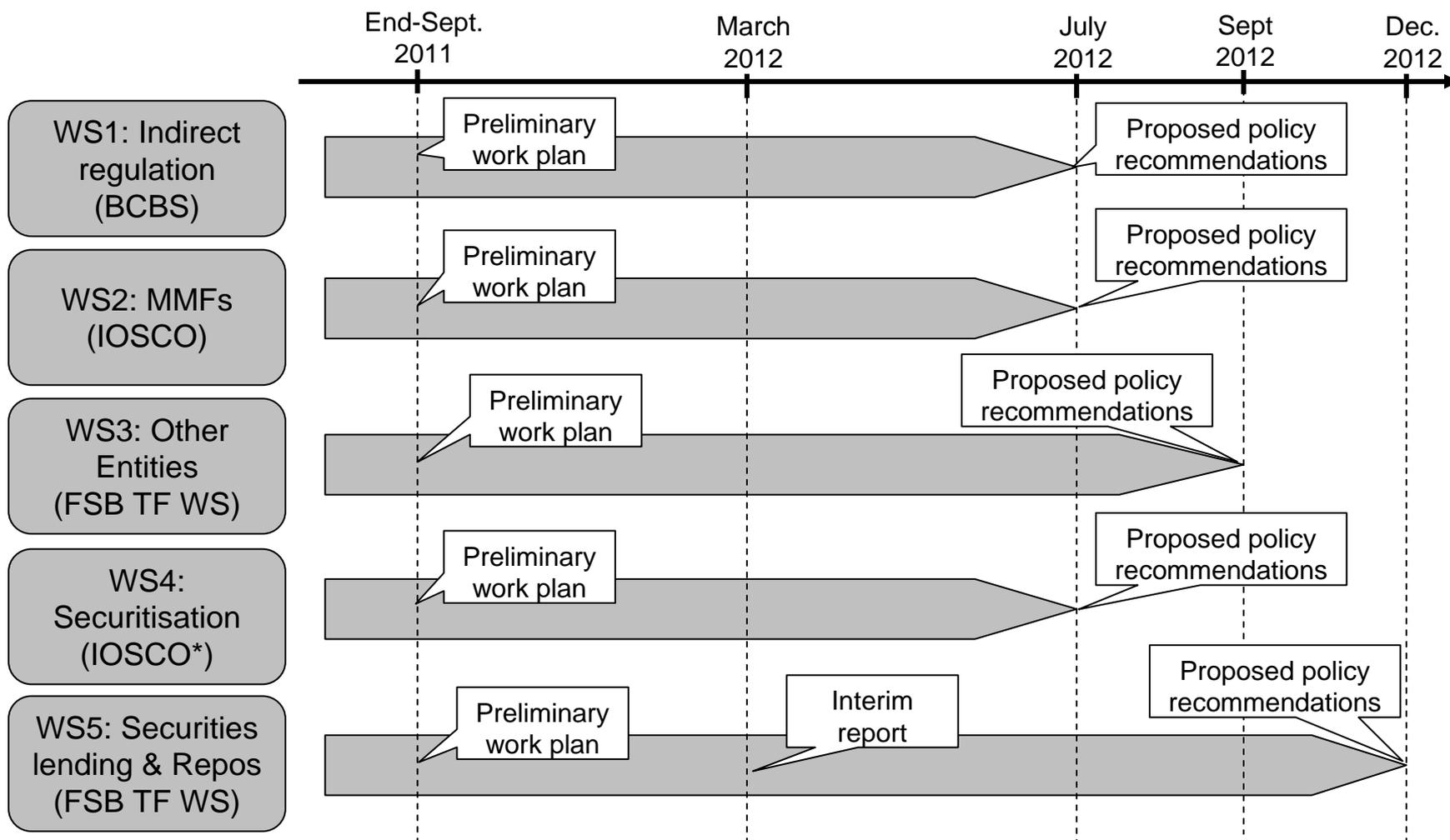
- **Banks' interactions with shadow banking entities (indirect regulation):** By regulating banks' interactions with shadow banking entities, the spill-over into the regular banking system will be reduced.
- **Shadow banking entities (direct regulation):** Shadow banking entities can themselves be regulated to reduce risks they pose to the system.
- **Shadow banking activities:** Authorities may intervene to address risk affecting particular instruments, markets or activities so as to facilitate sound non-bank credit intermediation.
- **Macro-prudential measures:** Policy measures can address systemic risk in the shadow banking system more broadly (eg regulatory measures for mitigating procyclicality or policies to strengthen market infrastructure to lower contagion risks).

Possible regulation of the shadow banking system (2): The five new workstreams

Based on a stock-taking exercise, the following 5 possible areas are identified for more detailed work:

- 1) Regulation of banks' interactions with shadow banking entities (indirect regulation): BCBS** to lead the work
 - consolidation rules for prudential purposes;
 - limits on the size and nature of a bank's exposures to shadow banking entities;
 - risk-based capital requirements for banks' exposures to shadow banking entities; and
 - treatment of implicit support.
- 2) Regulatory reform of money market funds (MMFs): IOSCO** to lead the work
- 3) Regulation of other shadow banking entities: New FSB TF Workstream** to lead the work
- 4) Regulation of securitisation: IOSCO, in coordination with BCBS,** to lead the work
 - in particular, with regard to retention requirements and transparency.
- 5) Regulation of securities lending/repos: New FSB TF Workstream** to lead the work

Possible regulation of the shadow banking system (3): Proposed timelines



*: In coordination with BCBS.