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Mr Svein Andresen
Secretary General
Financial Stability Board
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4002, Basel, Switzerland

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11th July 2011

Dear Mr Andresen,

Subject: Shadow Banking - Scoping the Issues

The International Banking Federation ('IBFed') is the representative body for national and international banking federations from leading financial nations around the world. Its membership includes the American Bankers Association, the Australian Bankers' Association, the Canadian Bankers Association, the European Banking Federation, the Japanese Bankers' Association, the China Banking Association, the Indian Banks' Association, the Korean Federation of Banks, the Assocation of Russian Banks and the Banking Association South Africa. This worldwide reach enables the Federation to function as the key international forum for considering legislative, regulatory and other issues of interest to the banking industry and to our customers.

The Federation considers that your paper represents a timely analysis of the issues. However, whilst the Federation would support future consideration of the risks posed by the shadow banking system, we would not wish to see the FSB proceed unduly quickly. A careful, pragmatic approach is needed which recognises changes being made to macro-prudential regulation and to the regulatory perimeter more generally. Indeed, the Federation would observe that the **form of the shadow banking system is closely linked to regulation and the unintended results of actions taken in this sphere**. Furthermore, the Federation would note that measures to directly regulate the shadow banking system may have potential implications for the liquidity and proper functioning of the markets which will require full consideration.

By way of summary, the IBFed believes that regulation of shadow banking should be pursued in a manner that recognises the following seven policy principles:

1. Promotes proper functioning of markets: Regulation should support market efficiency and liquidity whilst not impeding future market innovation.
2. Reduces likelihood of duplication: Regulation should avoid imposing obligations in a manner that creates duplication, for example, prudential regulation capital requirements and markets regulation financial requirements.
3. Minimizes economic impacts: Regulation should not unduly impact the ease of lending to economic activity and with it, global economic recovery.
4. Promotes a level playing field: Regulation should avoid imposing obligations in a manner that creates competitive distortions.
5. Enhances transparency: Regulation should seek to improve the availability of useful and meaningful market information for market participants and regulatory authorities.
6. Targets regulatory supervision: Regulation should not impose obligations on banks to police other financial institutions or entities.
7. Supports financial stability: Regulation should enhance economic processes, promote management of risks, and facilitate the ability for financial markets to absorb shocks to avoid widespread disruption to the financial system.

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With regard to background note prepared by the FSB´s Task Force on Shadow Banking, the IBFed would like to share with you the below detailed reflections.

Shadow banking definitional issues

1. The IBFed agrees with the FSB that there is **no agreed definition of the shadow banking system**. The IBFed notes, however, that the lack of a common, single definition of the banking system or even of global consistency over what a bank is and what it does has not prevented the global banking community from being brought under strict prudential regulatory standards and supervisory oversight. The **lack of an agreed definition on shadow banking should not be an excuse for regulatory and / or supervisory inaction**.

2. The IBFed agrees with the FSB that the shadow banking system could be defined, broadly speaking, as the "*system of credit intermediation (...) outside the regular banking system*". Furthermore, the IBFed agrees with the FSB that the "regular banking system" refers to an "*environment where the highest prudential regulatory standards and supervisory oversight are applied*" (page 5, second para).

3. Further to the above definitions, the Federation, however, disagrees with the characterisation of shadow banking in the Exhibit 1 "*The Structure of the Shadow Banking System*". The exhibit seems to question securitisation per se. The **IBFed opposes any definition of shadow banking that includes banks funding activities that are already regulated**. Banks-sponsored asset-backed commercial paper (ABCP) conduits and repo transactions are often a case in point**.** In a number of jurisdictions, ABCP conduits are on banks' balance sheet – hence subject to the same banks' accounting and regulatory requirements. Repo transactions are also operated within a fully regulated and monitored environment. The IBFed would like to remind that,

indeed, the current round of regulation has only increased the focus on bank funding activities in general and securitisation activity in particular (e. g. Basel III, Dodd Frank Act, stress testing...). Contrary to what the FSB seems to imply, such activities do not exist outside the view or reach of regulators / supervisors.

4. The IBFed considers that, in defining shadow banking, the focus **should mainly concentrate on credit intermediation activities - rather than solely on entities - that are outside existing regulatory reach.** And more properly, on the risks that such activities pose to the financial system, irrespectively of the legal status / form of the entities that carry them out. Consequently, the Federation considers that the focus of any definitional exercise should not be narrowed to concentrate on the subset of non-bank credit intermediation where maturity/liquidity transformation and/or flawed credit risk transfer and/or leverage create important risks. A broader definition would provide a better sense of systemic risk. **No portion of the shadow banking system should merit diminished attention from authorities**. It is the view of the Federation that a flexible forward-looking perspective is crucial to capture mutations in credit intermediation over time.

Shadow banking regulatory concerns

5. The IBFed agrees that the **transformation of credit risk outside the regular banking system may generate systemic risks and should therefore be monitored**. The Federation also shares the view that leverage within the shadow banking system may amplify procyclicality. In this regard, the IBFed is supportive of the recent work of IOSCO in defining the role of securities regulators in mitigating systemic risk[1] and the development of more formalised risk monitoring by macro-prudential regulators.

6. The FSB paper points at the interconnectedness between the shadow banking sector and the regulated financial sector. Such interconnectedness is logical, as both sectors are part of the same financial system. Furthermore, at least part of the interconnectedness stems from the regulated sector's desire to spread risk, which is a good risk management practice at the micro level. Therefore, the **objective should not be to do away with all interconnectedness, but rather to monitor interconnectedness and spot the channels through which risks are passed from the shadow banking sector to the regulated sector** to allow an appropriate response.

7. As long as different regulation and oversight between regulated banks and shadow banks exists, the Federation acknowledges that regulatory arbitrage opportunities could be exploited and these could, in turn, lead to potential financial stability concerns. In this regard, the Federation welcomes the fact that the FSB has underscored the **need for a global approach to monitoring shadow banking issues and proposing policy responses**.

Shadow banking monitoring

8. With regard to the use of quantitative and qualitative information for the monitoring of the shadow banking system, the Federation would like to highlight the importance of **supervisory global coordination and information exchange**. As a result of the global

[1] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD347.pdf

financial crisis, the reporting burden on banks has substantially increased. Smart data interrogation and analysis will certainly narrow apparent information gaps. Should new reporting requirements prove at all necessary, early engagement with the industry would be of paramount importance.

9. The Federation takes heed of the FSB's comments on the limitations of information about the credit intermediation activities of on non-bank entities. Such limitations could certainly have an impact on the development of monitoring activities and regulations. The Federation supports the work of IOSCO[2] and others in developing tools to try to overcome lack of information-related challenges.

10. The FSB rightly focuses on the part that macro-prudential supervision can play in identifying the build up of systemic risk. Whatever the focus of macro-prudential regulation at the domestic level (along the spectrum from pure risk monitoring to more interventionist attempts to mitigate systemic risk) the Federation believes that it is vital for national macro-prudential regulators to coordinate the way in which they gather data. The report is correct to highlight the inconsistency of current data requirements and the consequential gaps in the monitoring framework. Whilst the Federation can understand the issues this presents the authorities, it should be appreciated that it poses a major challenge to the industry also. The IBFed would strongly urge the FSB to build on the groundwork laid by the November 2009 report on the financial crisis and information gaps and develop a **common set of data requirements** with which firms will be expected to comply. Where possible, these should seek to harmonise definitions, levels of granularity and reporting timeframes. For financial institutions across borders, colleges of supervisors should be utilised to agree data requirements.

Regulatory action on shadow banking

11. The Federation supports the FSB´s suggestion that the **regulatory and /or supervisory response to shadow banking should be carefully balanced and targeted**. It should also be noted that a broad range of **indirect regulation**, i.e. regulating regulated institutions' interactions with shadow banking entities, is already in place (e.g. large exposure limits). Efforts to address risks posed by the shadow banking sector should not paradoxically lead to an undue increase in requirements -e.g. in terms of capital- for the already regulated sector and should be cognisant of the benefits generated by the shadow banking system.

12. With regard to the potential approaches for addressing shadow bank concerns, the Federation considers that **all entities that perform credit intermediation should be made subject to the same rules**. The non application (or light application) of prudential regulatory standards and supervisory oversight to entities that are engaged in activities similar to those of banks unlevels the playing field.

13. The IBFed is of the opinion that macro-prudential supervision is needed in order to ensure a level playing-field and an adequate outlook on structural trends. The first aspect of supervision being to prevent systemic risks, macro-supervision should therefore focus on types of risks, regardless of the entity or the mechanism that are involved.

[2] On February 2010, IOSCO published details of an agreed template for the global collection of hedge fund information to assist in assessing possible systemic risks arising from the sector.

14. Finally, the Federation notes that any regulatory response to the shadow banking system is likely to negatively impact the ease of lending to economic activity and with it, economic recovery. It should furthermore be noted that **any obstacles to the credit intermediation activity of non banks would come in addition to those imposed to the regulated banking sector**. Therefore, whilst the global banking community considers that a level playing field between banks and non banks should be achieved, the IBFed is also mindful of the additional impact that the application of prudential regulatory standards and / or supervisory oversight to non- banks may have for global economic recovery. As a result, the Federation considers that a holistic approach to the regulation of credit intermediation justifies a reconsideration of the prudential requirements imposed on the regulated banking sector.

We would like to thank you for the consideration of these general remarks and detailed reflections and are looking forward to learning about the Task Force initial recommendations to the FSB´s July 2011 Plenary meeting.

The IBFed would like to request that a second round of consultation, on the basis of a more elaborated paper, is carried out before the FSB submits its recommendations to the G20 in autumn.

Yours sincerely,

Sally Scutt
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IBFed

Pierre de Lauzun
Chairman
IBFed Financial Markets Working Group