Press release

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FSB Publishes Initial Integrated Set of Recommendations to Strengthen Oversight and Regulation of Shadow Banking

The Financial Stability Board (FSB) is publishing today for public consultation an initial integrated set of policy recommendations to strengthen oversight and regulation of the shadow banking system.

The "shadow banking system" can broadly be described as "credit intermediation involving entities and activities (fully or partially) outside the regular banking system" or non-bank credit intermediation in short.

The FSB has focused on five specific areas in which the FSB believes policies are needed to mitigate the potential systemic risks associated with shadow banking:

(i) to mitigate *the spill-over effect between the regular banking system and the shadow banking system*;

(ii) to reduce the susceptibility of *money market funds (MMFs)* to "runs";

(iii) to assess and mitigate systemic risks posed by *other shadow banking entities*;

(iv) to assess and align the incentives associated with *securitisation*; and

(v) to dampen risks and pro-cyclical incentives associated with *secured financing contracts such as repos, and securities lending* that may exacerbate funding strains in times of "runs".

The consultative documents published today comprise:

- a report entitled *An Integrated Overview of Policy Recommendations* which sets out the FSB's overall approach to shadow banking issues and provides an overview of its recommendations across the five specific areas;
- a report entitled *Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* which sets out a high-level policy framework to assess and mitigate bank-like systemic risks posed by shadow banking entities other than MMFs (other shadow banking entities) – (iii) above; and
- a report entitled *Policy Recommendations to Address Shadow Banking Risks in Securities Lending and Repos* that sets out 13 recommendations to enhance transparency, strengthen regulation of securities financing transactions, and improve market structure – (v) above.

The FSB welcomes comments on these documents. Comments should be submitted by **14 January 2013** by email to fsb@bis.org or post (Secretariat of the Financial Stability Board, c/o Bank for International Settlements, CH-4002, Basel, Switzerland). All comments will be published on the FSB website unless a commenter specifically requests confidential treatment.

As for other areas in which the FSB believes policies are needed, the Basel Committee on Banking Supervision (BCBS) will develop policy recommendations for area (i) above by mid-2013. As for areas (ii) and (iv) above, the International Organization of Securities Commissions (IOSCO) has set out final policy recommendations in its reports *Policy Recommendations for Money Market Funds* and *Global Developments in Securitisation Markets*.

The FSB will continue to review the progress of the workstreams and expects to publish final recommendations in September 2013. It will thereafter work on the procedures for the consistent implementation of the policy recommendations.

The FSB is also publishing today its second annual *Global Shadow Banking Monitoring Report*. The 2012 Monitoring Report has broadened its coverage to include 25 jurisdictions (all 24 FSB member jurisdictions and Chile), compared with 11 jurisdictions in 2011, and includes analyses on interconnectedness between banks and non-bank financial entities as well as on a specific non-bank financial subsector, namely finance companies. The main findings are:

- Non-bank financial intermediation grew rapidly before the crisis (in parallel with the regular banking system), from an estimated $26 trillion in 2002 to $62 trillion in 2007. It has continued to increase since, although at a slower pace, to $67 trillion at end 2011.
- There is considerable diversity in the relative size, composition and growth of the non-bank financial intermediaries across jurisdictions. For example, the size of the shadow banking system continues to be large relative to the regular banking system in the US and in a number of other jurisdictions. 17 jurisdictions out of 25 saw an increase in non-bank financial intermediaries since the crisis; half of these jurisdictions are emerging markets and developing economies undergoing financial deepening.
- Data granularity is improving, with the share of unidentified non-bank financial intermediaries within overall non-bank intermediation falling from 36% in 2010 to 18% in 2011. However, further improvements are needed in jurisdictions that still lack granular data to adequately capture the magnitude and nature of risks in the shadow banking system.

The FSB plans to complement the monitoring exercise next year by obtaining more granular data on assets and liabilities as well as expanding activity-based and risk-based monitoring. Enhanced data reporting and disclosure requirements as recommended in the FSB's consultative documents published today will be essential to provide the necessary basis for such an enriched monitoring.

Notes to editors

At the Cannes Summit in November 2011, the G20 Leaders endorsed the FSB's report *Shadow Banking: Strengthening Oversight and Regulation* which set out initial recommendations with a work plan to further develop them in the course of 2012. Five workstreams were launched to develop the above policy recommendations. The FSB submitted a [*Progress Report*] on these workstreams to the G20 Finance Ministers and Central Bank Governors on 20 April 2012.

The "shadow banking system" can broadly be described as "credit intermediation involving entities and activities (fully or partially) outside the regular banking system" or non-bank credit intermediation in short. Such intermediation, appropriately conducted, provides a valuable alternative to bank funding that supports real economic activity. But experience from the crisis demonstrates the capacity for some non-bank entities and transactions to operate on a large scale in ways that create bank-like risks to financial stability (longer-term credit extension based on short-term funding and leverage). Such risk creation may take place at an entity level but it can also form part of a complex chain of transactions, in which leverage and maturity transformation occur in stages, and in ways that create multiple forms of feedback into the regulated banking system.

Like banks, a leveraged and maturity-transforming shadow banking system can be vulnerable to "runs" and generate contagion risk, thereby amplifying systemic risk. Such activity, if unattended, can also heighten procyclicality by accelerating credit supply and asset price increases during surges in confidence, while making precipitate falls in asset prices and credit more likely by creating credit channels vulnerable to sudden losses of confidence. These effects were powerfully revealed in 2007-09 in the dislocation of asset-backed commercial paper (ABCP) markets, the failure of an originate-to-distribute model employing structured investment vehicles (SIVs) and conduits, "runs" on MMFs and a sudden reappraisal of the terms on which securities lending and repos were conducted. But whereas banks are subject to a well-developed system of prudential regulation and other safeguards, the shadow banking system is typically subject to less stringent, or no, oversight arrangements.

The objective of the FSB's work is to ensure that shadow banking is subject to appropriate oversight and regulation to address bank-like risks to financial stability emerging outside the regular banking system while not inhibiting sustainable non-bank financing models that do not pose such risks. The approach is designed to be proportionate to financial stability risks, focusing on those activities that are material to the system, using as a starting point those that were a source of problems during the crisis. It also provides a process for monitoring the shadow banking system so that any rapidly growing new activities that pose bank-like risks can be identified early and, where needed, those risks addressed. At the same time, given the interconnectedness of markets and the strong adaptive capacity of the shadow banking system, the FSB believes that proposals in this area necessarily have to be comprehensive.
