FSB FINANCIAL STABILITY BOARD

Press release

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FSB Publishes Policy Recommendations to Strengthen Oversight and Regulation of Shadow Banking

The Financial Stability Board (FSB) is publishing today policy recommendations to strengthen the oversight and regulation of the shadow banking system. These recommendations take into account public responses received on the consultative documents issued on 18 November 2012.

The FSB has focused on five specific areas in which 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 align the incentives associated with *securitisation*;

(iv) to dampen risks and pro-cyclical incentives associated with *securities financing transactions such as repos and securities lending* that may exacerbate funding strains in times of market stress; and

(v) to assess and mitigate systemic risks posed by *other shadow banking entities and activities.*

The documents published today comprise:

- a report entitled *An Overview of Policy Recommendations* that sets out the FSB's overall approach to addressing financial stability concerns associated with shadow banking, actions taken to date, and next steps.
- a report entitled *Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos* that sets out recommendations for addressing financial stability risks in this area, including enhanced transparency, regulation of securities financing, and improvements to market structure (ref. (iv) above). It also includes consultative proposals on minimum standards for methodologies to calculate haircuts on non-centrally cleared securities financing transactions and a framework of numerical haircut floors.
- a report entitled *Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* that sets out the high-level policy framework to assess and address risks posed by shadow banking entities other than MMFs (ref. (v) above).

As far as other shadow banking policy areas are concerned, the Basel Committee on Banking Supervision will complete its work in area (i) above in 2014, and the International Organization of Securities Commissions has already set out final policy recommendations for areas (ii) and (iii) above in its reports *Policy Recommendations for Money Market Funds* and *Global Developments in Securitisation Markets*.

Most of the policy measures on shadow banking developed by the FSB have now been finalised and will be adopted by FSB members in an internationally coordinated manner. However, the proposed minimum standards for methodologies to calculate haircuts on non-centrally cleared securities financing transactions and a framework of numerical haircut floors, will be defined in light of further assessments of their potential impact on the financial system. The FSB welcomes comments on the consultative proposals set out in Annex 2 of the *Policy Recommendations to Address Shadow Banking Risks in Securities Lending and Repos*. Comments should be submitted by **28 November 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.

The FSB, in coordination with the relevant standard-setting bodies, will monitor the implementation of the finalised policy recommendations on shadow banking. The FSB will also continue to review the progress of the remaining work to develop policy recommendations and report on progress to the G20 in November 2014.

Mark Carney, Chairman of the FSB, stated that "The policy recommendations issued by the FSB today address important sources of maturity transformation and leverage in shadow banking. Implementation of these recommendations will be an essential first step towards achieving our aim of transforming shadow banking into market-based financing conducted on a sound basis. This, in turn, will help diversify the sources of financing of our economies in a sustainable way and contribute to the G20's ultimate objective of strong, sustainable and balanced growth".

Daniel Tarullo, Chairman of the FSB Standing Committee on Supervisory and Regulatory Cooperation stated that "The policy framework for strengthening oversight and regulation of shadow banking entities will help authorities to better identify and address financial stability risks from shadow banking. This is especially important as tighter regulations on banks and other traditional market participants that are coming into effect may incentivise some risky activities to move to less tightly regulated sectors".

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. Five workstreams were launched to develop the above policy recommendations. In addition, the FSB has been conducting annual global shadow banking monitoring exercises through its Standing Committee on Assessment of Vulnerabilities to assess the global trends and risks in the shadow banking system, and to enable early detection of any rapidly growing new non-bank financial activities or entities that pose bank-like risks.

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 regular 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 loss 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 policies in this area necessarily have to be comprehensive.

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB is chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements. For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.