16 May 2011

Financial Stability Board
c/o Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

RE: Industry Comments on “Shadow Banking: Scoping the Issues”

To the Financial Stability Board,

1. **Executive Summary**

1.1 The Global Financial Markets Association (“GFMA”) members agree with the Financial Stability Board (“FSB”) that the “shadow banking sector” is an important source of alternative funding and liquidity to corporates, consumers, and market participants. Significant changes to bank prudential requirements in Basel III could lead to a need for increased non-bank funding to complement funding provided by banks.

1.2 Members support the FSB’s objectives to develop recommendations to clarify and set out potential approaches to monitor unregulated areas of the non-banking sector. We recognise that there may be gaps in monitoring for non-banking activities where systemic risk has not been addressed or identified.

1.3 We believe that the term “shadow banking system” is not an accurate representation of the landscape and risk of non-bank activities and entities. We agree that it is the non-bank activities that fall within the unregulated funding or investment areas that may pose a systemic risk or cause regulatory arbitrage that require greater transparency.

1.4 We support the approach the FSB has taken to first shape the definition of the “shadow banking” sector and then identify possible reporting or supervisory measures.
1.5 We support the FSB's view that a single regulatory approach for all non-banking activities is unlikely to be effective; differentiation is necessary to account for different business models, risk characteristics, and contribution to systemic risk.

1.6 Therefore, we recommend that the FSB focus on:

(i) non-bank credit intermediation (lending or investment) activities, and
(ii) which are unregulated or regulated in a materially different way than similar banking activities (including investment activities), and
(iii) activities which could be a source of systemic risk and/or regulatory arbitrage.

1.7 We recommend that any regulations or supervisory standards introduced by regulatory authorities should be proportionate and appropriate for the level of risk posed by the activity. In promoting stability, the FSB should ensure that there are no unintended adverse consequences. For instance, to prevent regulatory arbitrage, it is important that the framework does not create inappropriate incentives.

1.8 If regulators intend to create supervisory measures or regulation on the basis of risk, we request that the FSB provides clarity on the term “systemic risk.” We also request that the FSB clarify the terms “banking activities” and “non-banking activities.”

1.9 In particular, we support the promotion of increased transparency of unregulated activities through reporting and disclosure to the relevant authorities rather than other additional regulation, at this stage.

1.10 We believe that any existing and proposed definitions and implementation measures by the regulatory authorities on issues relating to this sector should be globally consistent.

1.11 We would like to engage in further dialogue and work with the FSB in developing the definition of the “shadow banking system” and means of increased transparency going forward.
2. **Definition of Shadow Banking System**

2.1 We agree with the FSB’s principle of defining the “shadow banking system” in the context of systemic risk and regulatory arbitrage and by economic substance rather than legal form/entity.

2.2 However, we believe that both the broad and narrow definitions of the “shadow banking system” provided by the FSB are too loosely defined and are inconsistent with the economic substance principle. We would recommend developing an alternative definition.

2.3 For instance, many of the activities captured by the definition are already heavily regulated or are within the scope of existing regulatory proposals. We recommend that the FSB review the extent of existing and proposed regulation of “shadow banking” activities, including what types of regulations the activities are subject to. The industry would be pleased to assist the FSB in this review.

2.4 We recommend that the definition should capture credit intermediation activities falling outside the regular banking system that can create systemic risk and/or regulatory arbitrage. It is the unregulated activities of non-bank lenders or originators that could cumulatively pose systemic risks, not the entities themselves. For example, in securitisation, it is the origination process/activity and the management of assets and liabilities that can create risk; therefore, SPVs as entities need not be captured. This approach would involve identifying activities and their associated risks.

2.5 Also, focussing the definition on entities or instruments would be inefficient and impractical. The complexity and wide variety of possible types of special purpose entities (e.g. SPV companies, trusts and/or funds) or the use of more than one special purpose entity within an overall activity/transaction would require a dynamic, highly flexible and tailored regulation, which may be difficult to achieve in practice.

2.6 In order to avoid duplication, any non-bank activity that is already regulated or subject to appropriate supervisory measures should not fall within the definition.
2.7 The section below sets out our concerns regarding specific types of entities and activities.

**Securitisation and Bank-Sponsored ABCP Conduits**

2.8 The FSB text raises a number of questions about securitisation. Securitisation involves a wide variety of activities and structures, and provides a large amount of funding for real economy assets. Many securitisation asset classes and structures have performed exceptionally well during the crisis. Members recommend that the FSB revisits the following issues:

- Securitisation is given as an example of flawed credit risk transfer by the FSB. We request that the FSB provides further clarification on the term “flawed”, so that any further regulatory changes in this area can be appropriately targeted. The industry also notes that many concerns regarding securitisation have already been addressed through a variety of regulatory changes and also industry-led initiatives.

- Securitisation is described as a mechanism that can enable maturity transformation. However, many if not most term securitisation vehicles are match-funded with no asset/liability mismatch or potential for systemic risk problems.

- ABCP vehicles are generally used to finance short term assets such as trade receivables. It is possible however that ABCP vehicles can create asset/liability mismatches. The facilities that support the activities of these vehicles are already subject to regulation by banking authorities. For example, individual liquidity and credit facilities, which are a necessary component for ABCP conduits, are fully covered by relevant regulations.

3. **Monitoring and supervisory measures**

3.1 We support a focus on monitoring “shadow banking” activities, in particular, for the purposes of gaining a micro and macro-prudential perspective to prevent systemic risk.

3.2 Macro-supervision should focus on types of risks, regardless of the entity, the mechanisms that are involved or specific activities. Therefore, we recommend the
FSB seek to address the primary criteria for identifying various risks and organise a fair and insightful monitoring system, which would match FSB’s objectives.

3.3 In order to identify possible sources of systemic risk, we believe that the appropriate supervisory authorities should be provided with the necessary information on non-regulated non-bank lending activities.

3.4 However, we recommend that the FSB does not directly or indirectly duplicate existing supervisory measures. In particular, regulatory authorities have a large amount of information available as a result of regulatory requirements under national banking regulations, CRD, Dodd-Frank and other regulations. Additional supervisory measures may create a further reporting burden on the banking system, which is already dealing with significantly increased requirements pursuant to existing and proposed measures.

3.5 Once the FSB provides clarity on the definitions of “systemic risk”, “banking activities” and “non-banking activities”, in order to clarify the scope of the FSB efforts we would greatly appreciate the opportunity to work with the FSB further on developing a suitable supervisory model.

Respectfully submitted,

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