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16 January 2013

Mr Svein Andresen
Secretary General
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
fsb@bis.org

Dear Mr Andresen,

Re: FSB Consultative Document on Strengthening Oversight and Regulation of Shadow Banking

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 Association 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 IBFed appreciates the opportunity to comment on the following Financial Stability Board consultation documents: *An Integrated Overview of Policy Recommendations*, *Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* and *Policy Recommendations to Address Shadow Banking Risks in Securities Lending and Repos*. Our comments on these three papers are set out below.

I. An integrated Overview of Policy Recommendations

- The different shadow banking documents of the FSB and IOSCO contain some overlaps and inconsistencies. The IBFed strongly suggests the integration of recommendations concerning money market funds (MMFs) and securitisation currently contained in the document of work stream 3 (Strengthening Oversight and Regulation of Shadow Banking Entities) in the policy recommendations of work streams 2 (on MMFs) and 4 (on securitisation) in order to develop a full impact assessment concerning these activities/entities. As an example, recommendations concerning Asset-Backed Commercial Paper in work stream 3 potentially impact on Asset-Backed Securities, and contrast with new consolidation perimeters announced for the (pending) work stream 1.
- The policy proposals, taken together have the potential to trigger a chain of effects due to higher costs and reduced market liquidity which ultimately will have a considerable impact on end users. We believe that these impacts should be estimated. We would like to emphasize the cumulative effect of the existing banking regulation and initiatives that are in the process of being introduced. For example, while noting the last sentence regarding Tool 8 of the paper on Other Shadow Banking Entities : “It should be noted that if an entity is captured in consolidated supervision of a parent bank, many of the above tools may already be in place,” we remain concerned that insufficient account is being taken of existing regulation or international responses. The interplay between the proposals and other regulatory initiatives (including proposals concerning capital and liquidity requirements) should be monitored so as to avoid inconsistencies and unnecessary measures that have unintended consequences.
- While the industry acknowledges that proper and robust credit assessment processes should be in place at all times and an overreliance on external ratings avoided, the artificial elimination of references to external ratings creates perverse incentives and decreases risk sensitivity. For example, minimum repo haircuts may not be differentiated by credit quality/ external ratings.

II. Policy Framework for Strengthening Oversight and Regulation of Shadow Banking entities

- The proposals under work stream 3 related to funds/hedge/private equity/ money market funds / credit funds would significantly increase the regulation of funds. The additional costs and limitations for the funds in question, in conjunction with a reduced funding capacity due to limitations on banks to procure funding to said funds (in conformity with work stream 1 on indirect regulation), may have far-reaching consequences, not only for the funds in question, but equally for end users and in particular for pension funds and their beneficiaries.

We urge the FSB to assess the combined impact of new fund regulation before requiring other shadow banking entities to comply with the recommendations of work stream 3. Some of the more far-reaching proposals may prove redundant or the risk

may have already been mitigated by new fund regulations (SEC 2010 reforms in the USA and AIFMD and UCITS in Europe).

- The frequent mention of “run risk” suggests a desire to focus on systemic risk events rather than particular issues. To reduce negative impacts on funds and end users, the FSB may wish to consider a full range of available alternatives since the financial crisis that would reduce the likelihood and/or enable funds to stop or slow possible runs. Moreover, enhanced transparency could be used to ensure that retail investors understand the risk distinction between deposits and investments.
- The paper suggests (page 21) that banks are inclined to use securitisation as a “cheap” funding source. Given new regulations for banks (Basel 2.5 and 3, work stream 5 on shadow banking) and for investors in securitisation (notably Solvency 2 in the EU), securitisation is highly unlikely to be “cheap” in future. Securitisation, however, is crucial to procure alternative and more diversified funding sources, especially for mortgage banks, as well as to enable banks to play their proper role in society of financing economic growth, which they are committed to doing.
- The combination of work stream 1 (indirect regulation), work stream 3 and proposals in the US and in Europe on bank restructuring are likely to significantly reduce the investment of banks in private equity. On the other hand, the importance of private equity in the current climate of bank deleveraging is increasing, especially for the SME segment. Bank-affiliated private equity (PE) groups account for 30% of all PE investments¹. This should be carefully weighed prior to proposing a final recommendation.

III. Policy Recommendations to Address Shadow Banking Risks in Securities Lending and Repos

Securities lending and repos are an integral part of ensuring that government bond markets, covered bond markets and other fixed income markets are liquid, accurately priced, efficient and credible. The establishment of a numerical floor on haircuts would be a material change for the securities lending and repos market and should be reconsidered in our view. Improvements in transparency are welcome, but should seek to rely as much as possible on existing data. We have the following remarks to make on this proposal.

- We support improvements in transparency to enable the more accurate assessment of risk by regulators, investors and the market. Reporting requirements should be aligned so as to ensure global consistency. When gathering data, regulators should carefully consider what information is most relevant or useful. In addition, preference should be given to data that is already broadly available, such as information provided to regulators and data vendors.
- While trade repositories may offer transparency benefits, they are likely to be costly to implement and operationally complex. They are also not necessarily the most

¹ Source: Harvard Business School, April 2012, “Combining Banking with Private Equity Investing”

effective way to assess emerging risk. Moreover, experience from some markets suggests that it can take a period of years to establish effective trade repositories. Reliance on existing exposure-based reporting may therefore be the most effective solution and should be thoroughly explored before adopting any alternative arrangement. We therefore suggest that the FSB assess with local regulators current practice as an avenue to reaching the objective of enhancing transparency.

- Onerous haircuts can have unintended impacts, including increased risk. Rigid haircuts, particularly in combination with other regulatory developments, may reduce market liquidity by discouraging investor participation. Also, excessive haircuts will leave firms pledging collateral with an un-hedged exposure to their counterparty. If the collateral receiver's financial position were to weaken, the collateral provider may seek to reduce or even eliminate transactions with that entity. This could contribute to market stress, as the pledging firm pulls balances from the collateral receiver, creating a run on both lending and collateral pools.
- The impact that minimum haircuts would have on the liquidity of repo and securities lending markets is difficult to assess. Introducing minimum haircuts without a comprehensive assessment of the anticipated impact on liquidity would be irresponsible in our view. The upcoming regulation should fully take into account the growth in importance of repos and securities lending as a result of banking regulation.
- Any approach ultimately chosen needs to guarantee a sufficient degree of flexibility and avoid overly uniform or rigid requirements in order to allow a risk-based approach, consistent with the firm's risk management capabilities.
- To avoid inconsistencies or even outright conflicts, further requirements need to be aligned with corresponding provisions in other regulatory frameworks, in particular capital requirements. Market participants' risk management systems need to be able to rely on approaches consistent with risk-based capital regimes, including reliance on individual models and systems.

We hope you find our comments on the three papers useful. Please let us know if you have any further questions or would like to discuss our recommendations in further detail.

Yours sincerely,



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Barbara Frohn
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