

# THE GLOBAL REGULATORY REFORM: INITIATIVES AROUND SHADOW BANKING

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- 1. CORRECTING THE FAULT LINES EVIDENCED BY THE CRISIS**
- 2. PROMOTING SAFER FINANCIAL MARKETS**
- 3. REINFORCING THE GLOBAL FINANCIAL SYSTEM**

## **1. CORRECTING THE FAULT LINES EVIDENCED BY THE CRISIS**

- Increase the resilience of financial institutions: higher capital requirements, new liquidity buffers
- Enhance transparency in the Banking sector (EDTF)
- Ending TBTF: “Key Attributes”, recovery and resolution plans, higher loss absorbency
- Filling regulatory gaps: systemic firms (non-bank, non-insurance) subject to resolution
- SHADOW BANKING



## 2. PROMOTING SAFER FINANCIAL MARKETS

- Derivatives reform: standardisation, clearing through CCPs, data repositories for OTC derivatives
- Ensure that market infrastructures are not a source of systemic risk (CCPs, payment systems, securities depositories, securities settlement systems).
- Adapt resolution regimes to infrastructures
- Credit Rating Agencies: reform governance (conflicts of interest), reduce reliance



## 3. REINFORCING THE GLOBAL FINANCIAL SYSTEM

- Ensure the consistent implementation of reforms (peer reviews)
- Allow for greater mutual reliance: mutual recognition, substituted compliance
- Increase cooperation and information exchanges (SIFIs, RRP)



## 4. WHAT IS THE SHADOW BANKING SECTOR?

- Financial institution that deals with credit risk, can be highly leveraged, that shows asset liability maturity mismatch and is not subject to banking Regulation: in short, non-bank credit intermediation
- No negative connotation: SB is an important source of financing for the real economy
- What are we exactly talking about?
  - A variety of institutions like MMFs, Investment Funds, Hedge Funds, Structured Finance Vehicles, Broker Dealers, US Financial Holding Companies, Dutch Special Financing Institutions, etc.
  - Not all of them deal with credit risk; not all of them pose a threat to financial stability
- Size: not easy to evaluate, but the size is well above that of World GDP (EU, US)




## 5. WHY DO WE CARE ABOUT SHADOW BANKING

- Unstable nature of Banks: prone to runs. Institutional, sophisticated investors do also run (lesson from the crisis).
  - That is why we regulate Banks: capital requirements, liquidity buffers
  - That is why we also give them access to CB money (LLR)
- SB share characteristics with Banks (CNAV MMFs, SIVs, etc.) but do not have equivalent Regulation or Supervision
- SB not isolated. On the contrary, highly interweaved with the Banking sector: spillover effects from SB to Banks
- SB were a very important element in the crisis (SIVs, MMFs): capital arbitrage motivation in most cases
- Going forward, given the tougher regulation on Banks, we may see more capital arbitrage going through the SB sector



## 6. WHAT ARE WE GOING TO DO ABOUT SHADOW BANKING

- Improve monitoring in order to understand developments around SB
  - Need to improve knowledge about its functioning at a global level
  - SCAV (FSB macroprudential subgroup): Global SB Monitoring Report
- But... still in the infancy
  - Complex issue due to complex interlinkages 
  - Macro SB trends may indicate clue, but vulnerability assessment requires micro judgement



## 7. MEASURES TO DEAL WITH SB RISKS

- This is a natural territory for the SRC (FSB). Ongoing work in 5 workstreams:
  - a. Interactions of SB with Banks: control of SB through the Regulation of Banks' relationships with SB (indirect regulation). BCBS territory.
  - b. MMFs
  - c. Other SB entities: Hedge Funds, non-financial companies with strong arms
  - d. Securitisation (IOSCO)
  - e. Repos and Securities lending





## 8. PROGRESS IN SPECIFIC AREAS

**a) Regulation of interactions between banks and SB:** limits to large exposures, compulsory consolidation of securitised assets (BCBS working on specific proposals)

### **b) Regulation of SB institutions**

**MMFs:** focus with Constant NAV MMFs. Transform into variable NAV or valuation buffer

**Other institutions:** regardless of their legal form, regulation based on the activities they carry out:

- Investment vehicles susceptible to runs
- Credit intermediation dependent on short term funding
- Intermediation in market activities dependent on short term funding or on secured funding
- Facilitation of credit creation
- Securitisation based credit intermediation and funding of financial entities



## 8. PROGRESS IN SPECIFIC AREAS (continued)

### c) Regulation of SB activities:

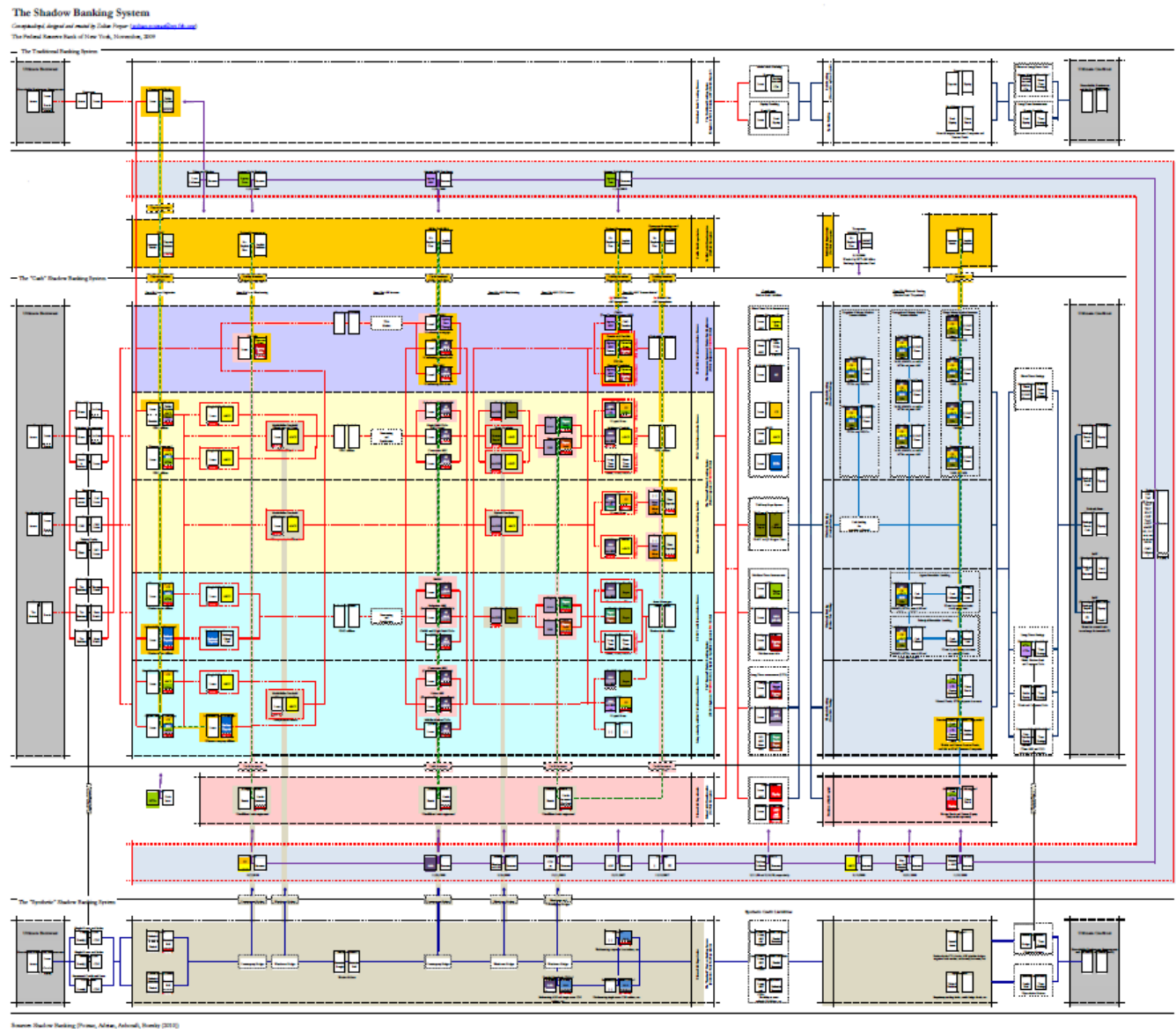
**Securitisation:** align incentives between originators and investors by imposing risk retention on originators, improving transparency and promoting standardisation

**Securities lending and repos:** proposals on enhanced transparency, standards on re-use of collateral, standards on collateral valuation and management, methodologies for the calculation of haircuts, minimum haircuts for non-sovereigns



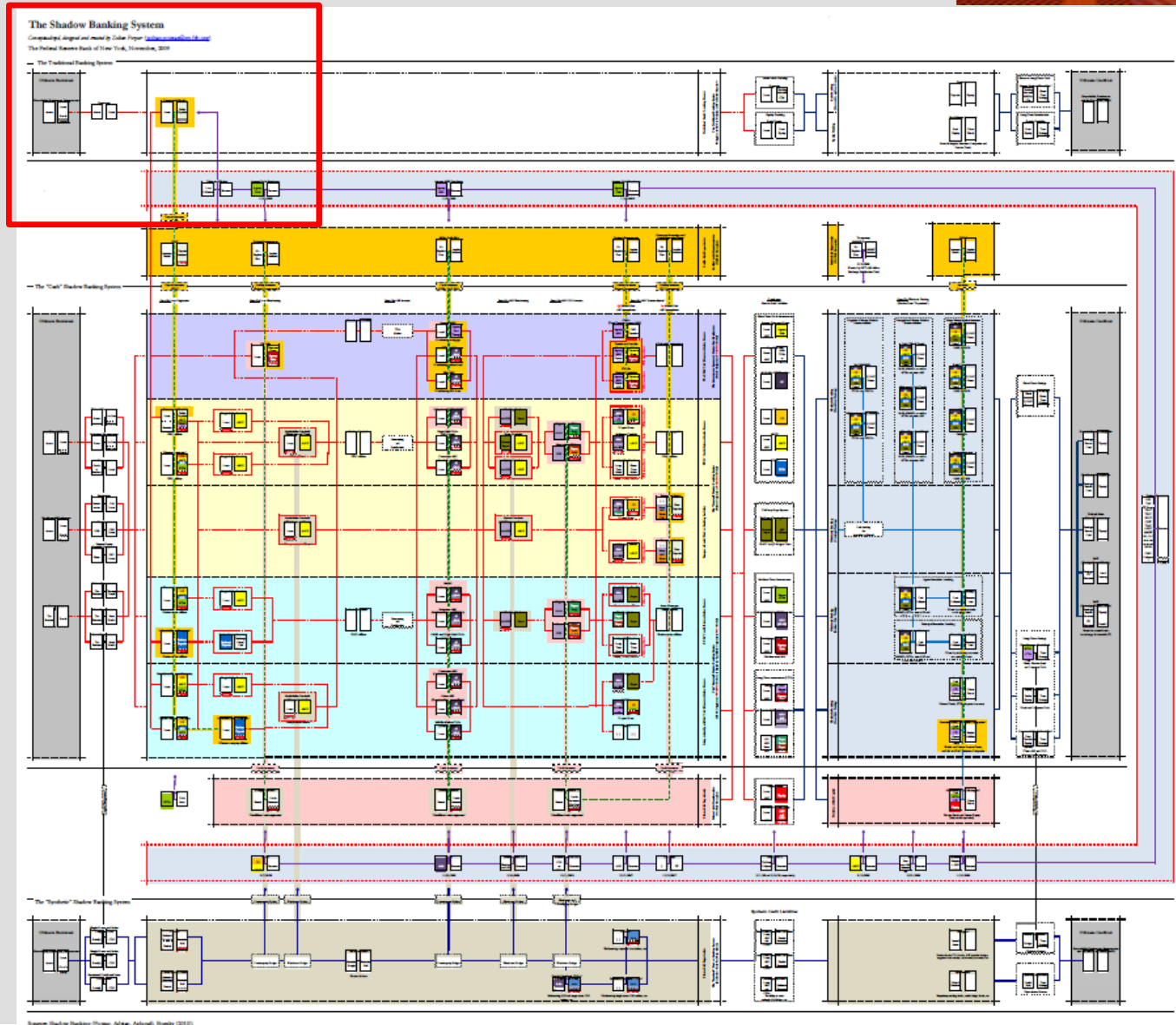
- **Shadow Banking plays a role in the financing of the real economy...**
- **... but SB was a source of systemic risk in the crisis...**
- **...and its problems impacted banks through complex but relevant channels**
- **Going forward, the FSB is designing a monitoring and regulatory framework**
- **There is a determined commitment to get these reforms done:**
  - **G20 Roadmap**  
<http://www.g20.org/documents/#p2>
  - **EU Communication**  
[http://ec.europa.eu/internal\\_market/finances/shadow-banking/index\\_en.htm](http://ec.europa.eu/internal_market/finances/shadow-banking/index_en.htm)

# ANNEX: complex interlinkages



Source: Pozsar et al. (2012): "Shadow Banking". FRBNY

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