FINANCIAL STABILITY BOARD

Press release

Press enquiries:
+41 61 280 8138
Joe.Perry@fsb.org

Ref no: 4/2018
5 March 2018

FSB publishes Global Shadow Banking Monitoring Report 2017

The Financial Stability Board (FSB) today published the *Global Shadow Banking Monitoring Report 2017*. The Report presents the results of the FSB's seventh annual monitoring exercise to assess global trends and risks from shadow banking activities. The 2017 monitoring exercise covers data up to end-2016 from 29 jurisdictions, which together represent over 80% of global GDP, including, for the first time, Luxembourg. Also for the first time, the Report assesses the involvement of non-bank financial entities in China in credit intermediation that may pose financial stability risks from shadow banking, such as maturity/liquidity mismatches and leverage.

The global monitoring of developments in the shadow banking system is part of the FSB's strategy to transform shadow banking into resilient market-based finance. The monitoring exercise adopts an activity-based approach, focusing on those parts of the non-bank financial sector that perform economic functions which may give rise to financial stability risks from shadow banking.

The main findings from the 2017 monitoring exercise are as follows:

- The activity-based, narrow measure of shadow banking grew by 7.6% in 2016 to $45.2 trillion for the 29 jurisdictions. This represents 13% of total financial system assets of these jurisdictions. China contributed $7.0 trillion to the narrow measure (15.5%), and Luxembourg $3.2 trillion (7.2%).
- Collective investment vehicles with features that make them susceptible to runs (e.g. open-ended fixed income funds, credit hedge funds and money market funds), which represent 72% of the narrow measure, grew by 11% in 2016. The considerable trend growth of these collective investment vehicles - 13% on average over the past five years - has been accompanied by a relatively high degree of investment in credit products and some liquidity and maturity transformation. This highlights the importance of implementing the FSB policy recommendations to address structural vulnerabilities from asset management activities published in January 2017.
- The assets of market intermediaries that depend on short-term funding or secured funding of client assets (e.g. broker-dealers) declined by 3%. These intermediaries accounted for 8% of the narrow measure by end-2016. Reflecting their business models,

broker-dealers in some jurisdictions employ significant leverage, although it is lower than the levels prior to the 2007-09 global financial crisis.

- The assets of non-bank financial entities engaged in loan provision that is dependent on short-term funding, such as finance companies, shrank by almost 4% in 2016, to 6% of the narrow measure. In some jurisdictions, finance companies tend to have relatively high leverage and maturity transformation, which increases their susceptibility to roll-over risk during period of market stress.
- In 2016, the wider "Other Financial Intermediaries" (OFIs) aggregate, which includes all financial institutions that are not central banks, banks, insurance corporations, pension funds, public financial institutions or financial auxiliaries, grew by 8% to $99 trillion in 21 jurisdictions and the euro area, faster than banks, insurance corporations and pension funds. OFI assets now represent 30% of total financial assets, the highest level since at least 2002.

The 2017 monitoring exercise also benefited from improved data submissions by authorities to measure interconnectedness among financial sectors and to assess short-term wholesale funding trends, including repurchase agreements (repos). On an aggregated basis, both banks' credit exposures to, and funding from, OFIs have continued to decline in 2016, and are at 2003-06 levels.

Mark Carney, Chair of the FSB and Governor of the Bank of England, said "The sustained growth in non-bank financial activity highlights the value of the FSB's shadow banking monitoring in allowing authorities to track and understand developments. Market-based finance provides increasingly critical alternatives to bank lending in the financing of economic growth, and it is vital that resilience of the sector is maintained as it continues to evolve. A close understanding of emerging risks helps guide our judgement on appropriate policy responses, such as the FSB's 2017 recommendations to address structural vulnerabilities from asset management activities which will be operationalised this year."

Klaas Knot, Chair of the FSB Standing Committee on Assessment of Vulnerabilities and President of De Nederlandsche Bank, said "The monitoring exercise has made further progress in 2017 by expanding its geographical coverage and deepening the analysis of associated financial stability risks, reflecting improved data submissions. Given the evolving nature of shadow banking into new forms and across borders, the FSB continues to work on further improvements to data availability and risk analysis so that new sources of systemic risk can be identified in a forward-looking manner."

Notes to editors

The FSB defines "shadow banking" broadly as "credit intermediation involving entities and activities (fully or partially) outside the regular banking system". Such intermediation, appropriately conducted, provides a valuable alternative to bank funding that supports real economic activity. But experience from the 2007-09 financial 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 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.

In response to a G20 Leaders' request at the Seoul Summit in 2010, the FSB has adopted a two-pronged strategy to address the financial stability risks in shadow banking and transform it into resilient market-based finance. First, the FSB has created a system-wide monitoring framework to track developments in the shadow banking system with a view to identifying the build-up of systemic risks and initiating corrective actions where necessary. Second, the FSB has been coordinating and contributing to the development of policies in five areas where oversight and regulation needs to be strengthened to mitigate the potential systemic risks associated with shadow banking, with a focus on measures that seek:

(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 to "runs";

(iii) to improve transparency and to align incentives associated with securitisation;

(iv) to dampen pro-cyclicality and other financial stability risks associated with securities financing transactions; and

(v) to assess and mitigate financial stability risks posed by other shadow entities and activities.

In relation to enhancing system-wide monitoring and (iv) above, the FSB has approved in October 2017 the operational arrangements to initiate data collection and aggregation of global securities financing transactions, beginning with end-2018 data. The FSB is publishing today the reporting guidelines for this data collection.

In July 2017, the FSB reported to the G20 Leaders its assessment of the evolution of shadow banking activities and risks since the financial crisis, and the adequacy of post-crisis policies and monitoring to address these risks. The assessment underscored the importance of a system-wide oversight framework, and recommended further strengthening of the oversight and monitoring of shadow banking activities, and enhancements to the data collection framework. At the time of the assessment, the FSB did not identify new financial stability risks from shadow banking that would warrant additional regulatory action at the global level. New forms of shadow banking were nevertheless likely to develop in the future, emphasising the importance of continued monitoring to mitigate associated risks and support the transformation of these activities into resilient market-based finance. To address residual gaps and further enhance oversight, FSB member authorities agreed in that assessment on seven recommendations, four of which relate to this annual monitoring exercise.

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 also conducts outreach with 65 other jurisdictions through its six regional consultative groups.

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.fsb.org.