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Re: FSB Consultative Documents on *"Strengthening Oversight and Regulation of Shadow Banking: An Integrated Overview of Policy Recommendations", "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities"* and *"Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos"*

On behalf of the Shadow Banking Advisory Group of the Institute of International Finance (IIF), the global association of financial institutions, we welcome the opportunity to comment on the three Consultative Documents *"Strengthening Oversight and Regulation of Shadow Banking: An Integrated Overview of Policy Recommendations", "Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities"* and *""Strengthening Oversight and Regulation of Shadow Banking: A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos"* issued by the Financial Stability Board (FSB) in November 2012 (henceforth, "the three FSB Consultative Documents").

Summary of Comments

We have set out our recommendations in more detail in the pages below. Our key points are that:

i. We support the FSB's overall objective of mitigating the potential systemic risk from non-bank credit intermediation while at the same time avoiding regulatory arbitrage and preserving the benefits of such intermediation. This objective also motivated our June 2012 paper: "*'Shadow Banking': A Forward-Looking Framework for Effective Policy*" (attached and henceforth "the June 2012 IIF Paper).

ii. However, we are concerned that despite the best efforts of the FSB and national regulators, the current FSB policy process and approach set out in the three FSB Consultative Documents could potentially hinder it in achieving that objective.

iii. In particular, we are concerned that the current policy process is insufficiently coordinated and consistent across workstreams, notably by taking a different approach to Other Shadow Banking Entities than the approach taken in the other workstreams and in the overall approach. In some cases, the approach taken in one workstream is inconsistent with that taken in another. There is also considerable duplication, leading to the same risk being addressed in more than one workstream, leading to overlap and inefficiency, and undermining the FSB's objective of a proportionate and targeted approach.

iv. We also believe that the FSB would benefit from taking more time to develop a fuller – macroprudential - understanding of the non-bank financial system and its interconnectedness with the banking system; to consider the cumulative impact of its proposed reforms so as to ensure a stable and sustainable supply of credit to the economy; and to allow interested parties of all perspectives sufficient time to examine the proposals as a whole when they are finally released. Given the extension of the deadline for action in this area to September 2013, we encourage the FSB to consider carrying out an additional consultation on the entirety of the reform package in Summer 2013.

v. We are also concerned that the proposed approach – both in the Integrated Overview document and in the Other Shadow Banking Entities document (henceforth 'the OSBE paper') – may not serve the FSB's objectives because it is too focused on entities and on delineating and categorizing "shadow banking" and could potentially ignore risks emerging elsewhere in the non-bank financial sector, for example the risks posed by financial market infrastructures.

vi. We feel that the proposed approach is also somewhat focused on risks that emerged during the financial crisis rather than being adaptable to new risks in different forms and unnecessarily rigid – particularly in the economic functions approach taken in the OSBE paper.

vii. We note that the proposed approach, in particular the one adopted in the OSBE paper, assumes that new regulation is the only risk mitigation tool. That approach does not take sufficient account of existing regulation or other available risk mitigation tools such as codes of conduct, greater disclosure, enhanced transparency or investor education that might be more effective and proportionate in addressing any risks identified.

viii. In line with our June 2012 Paper, we believe that the FSB and national regulators would have considerably more success in achieving their objective in this area if they expanded their focus to "non-bank financial activities" rather than keeping a narrower "shadow banking" focus, which may ultimately interfere with the goal of implementing an effective, proportionate and targeted approach.

ix. Indeed we feel that the approach outlined in the June 2012 IIF Paper of identifying risks from non-bank financial activities, assessing those risks and mitigating them would better help the FSB to achieve its aims, by combining:

   a. Macroprudential oversight of the entire financial system; and

   b. A case-by-case international approach to the mitigation of risks from individual activities, employing a graduated series of options.

x. The FSB has already adopted this approach for parts of its work – for instance in its approach towards securities lending and repo – but we strongly recommend that it be extended to the entirety of its work in this area.

xi. We also believe that there would be benefit in the FSB considering the role and obligations of other actors in the financial system: banks, investors, end-users and the market as a whole.

The FSB's Overall Objectives

The IIF strongly supports the overall objectives of the FSB's work in this area and the increased international focus on addressing risks from the non-bank financial system, in particular those activities that contribute to non-bank financial intermediation, which the FSB refers to as "shadow banking".

We also agree with the FSB that the aim should be a comprehensive and targeted approach that mitigates systemic risk and avoids regulatory arbitrage, while preserving the benefits of non-bank financial activities.

In this regard, we support the FSB acknowledgement of the beneficial aspects of many non-bank financial activities. In the June 2012 IIF paper we argued that when properly structured and with risks properly managed, non-bank financial intermediation activities can provide significant benefits to investors, borrowers and the wider economy.

However, in that paper, we recognized that many non-bank financial activities which developed in the years leading up to the global financial crisis could as the crisis showed create substantial and even systemic risks, if adequate disclosure and risk mitigation were not in place. Thus, we broadly agree with the FSB's analysis of what went wrong in the lead up to the financial crisis. As we said in the paper:

"*The lesson of the crisis however is that, absent these [risk mitigation] safeguards, [non-bank financial activities] can create substantial risks either separately, in combination with other activities inside the entity undertaking them or as a result of their interactions with the financial system as a whole. […] If these risks are not managed and mitigated effectively and become sufficiently material, they may destabilize the financial system and/or lead to a widespread loss of confidence".*

We are therefore keen to collaborate with the FSB to ensure effective policy in this area and welcome the FSB's consultation. We recognize that effective policy and risk mitigation is a responsibility not only of regulators and supervisors, but also of the financial services industry itself. For this reason, we set out in the June 2012 IIF Paper a three-step approach that we believe will best achieve this result, which is to identify, assess, and mitigate the risks in the non-bank financial sector. We believe that there needs to be an effective dialogue and communication between regulators and all parts of the industry to share analyses of risks, how best to mitigate them, and where necessary to identify information gaps.

Further, we welcome the efforts of the FSB, Basel Committee, the International Organisation of Securities Commissions (IOSCO), European Commission and others to promote greater international coordination and consistency of policy across jurisdictions. Such coordination and consistency is essential. However, despite these efforts, there is a possibility that differences in policy objectives – for example the emphasis placed by the

European Commission on regulatory arbitrage in addition to systemic risk – could lead to inconsistent policy across jurisdictions.

The FSB Workstream and Consultation Policy Process

Policy makers, regulators, and providers of bank and non-bank financial activities alike all have an interest in ensuring that the policies adopted in this area:

- take account of the variety and complexity of non-bank forms of intermediation and avoid the temptation to adopt a "one size fits all" approach;
- are forward-looking and adaptive;
- are premised on effective macroprudential oversight and analysis;
- make use of the whole range of tools available to mitigate any potential risks and in so doing use the proportionate yet effective tool(s) in a way that is consistent with – but not necessarily identical to - the approach taken to similar activities, and
- are internationally consistent and coordinated.

These issues are very difficult and it is vital that we get them right. If we do not, there could be significant negative consequences in terms of restricting access to credit to those who need it and migration of risk.

In this respect, we are concerned that the current FSB policy process may not be helping it or the policy community as much as it could to best achieve these aims. We have five concerns in particular.

1. **The current process is insufficiently coordinated across workstreams and with the wider financial reform process.**

We are concerned that despite the best efforts of the FSB and national regulators, there is considerable overlap, inconsistency and confusion between the approaches taken in the different workstreams and the wider financial reform process.

Although some of the workstreams have finalized their recommendations, and others have different timeframes within which to finalize their work, these workstreams are closely connected with each other. Decisions taken on securitization for example have an impact on the workstream on banks' interactions with shadow banking entities and activities. Decisions on securities lending also affect Money Market Funds. Economic Function 5 in the OSBE paper involves securitization yet takes a different approach to that taken by IOSCO in its final securitization paper. Similarly recommendations on Asset-Backed Commercial Paper (ABCP) in the OSBE paper contrast with the new consolidation rules being proposed under Workstream 1.

It is difficult to see how coordination can be ensured if decisions are taken at different times and without an adequate opportunity for both regulators and interested parties to consider them as a whole. Indeed given that the OSBE paper's recommendations are much more general than the other workstreams and – as we argue below, if workable should be applied to non-bank financial activities as a whole – it would have been better to have this workstream report first, ahead of the other workstreams.

These concerns are not limited to the work on shadow banking. To give just one example: in December 2012, the Basel Committee on Banking Supervision (BCBS) released a consultative document "*Revisions to the Basel Securitisation Framework*" setting out a possible approach to revise the Basel capital framework's treatment of securitization exposures. Whatever the merits of the approach taken in that consultative document, there is little sign of coordination between this work process, the treatment of securitization in Workstream 2 on securitization, the treatment of banks' interactions with shadow banking in Workstream 1, and the treatment of securitization in Economic Function 5 of the OSBE paper. For instance, it is not clear whether the introduction of the Modified Supervisory Formula Approach (MSFA) in the Basel Committee consultative document already deals with the concerns on the maturity mismatch associated with ABCP.

While much of this work has now been completed, we hope that the FSB will review its governance structure on these issues and on non-bank financial activities more broadly and decide whether this structure needs to be changed to ensure more effective coordination in future.

2. It is unclear why the approach on Other Shadow Banking Entities has not been applied to non-bank financial activities as a whole.

As we explain below, we have major reservations about the proposed approach in the OSBE Paper and believe that if implemented, it would get in the way of effective risk mitigation in the non-bank financial system. However, even if an effective approach were to be developed, it is unclear why this should apply only to those activities and entities not covered by the other workstreams rather than to non-bank financial activities as a whole, including Money Market Funds, securitization, and securities lending and repo. We understand that the relevant Task Force complied with the mandate set for them but would ask the FSB to consider whether, on balance, making such a distinction really works. Indeed, we believe that the FSB should adopt an approach that works for and is consistent across the entire non-bank financial system (and for reasons set out below, goes wider than "shadow banking" or "non-bank credit intermediation").

3. There needs to be a fuller understanding of the non-bank financial system and of its connections with the banking system.

We share the concerns of IOSCO Secretary-General David Wright[1] that policy is being developed before there is a full understanding of the non-bank financial system and of its connection with the banking system, both direct and indirect. If risks are to be most proportionately yet effectively mitigated, it is essential to understand the system as a whole,

[1] http://iosco.org/library/speeches/pdf/20121210-Wright-David.pdf

including financial market infrastructures, and where the various risks lie and are most concentrated. Such an approach must involve macroprudential oversight bodies, prudential regulators, insurance regulators, and conduct-of-business regulators all sharing information on the risks and the extent to which they are being mitigated. As we suggested in the June 2012 IIF Paper, this approach also means having in place sufficient transparency and availability of data.

4. There needs to be full consideration of the cumulative impact of proposed reforms

We also agree with Secretary-General Wright's comments in the same speech that there has not been sufficient consideration of the cumulative impact of these proposed reforms. Indeed while many of the recommendations made with respect to individual non-bank financial activities may make sense in their own right, there appears to have been no cost-benefit analysis of the overall impact on the activity, the financial system or the wider economy if all of the recommendations were to be adopted. Nor is there consideration whether there is existing prudential, conduct-of-business or other regulation that could be adjusted, or if not, which form of new or additional regulation would be the most cost-effective.

We are concerned that the cumulative effect of the reforms as currently proposed could lead to a reduction in the supply of credit, higher overall costs and reduced market liquidity, with considerable negative impact on end-users, including reduced access to funds and detriment to the wider economy. This effect is opposite to that intended by the FSB.

5. The limited deadlines for responses to consultations do not give interested parties sufficient time to work through all the details and provide the most considered and constructive comments.

While the IIF's Shadow Banking Advisory Group has done its best to consider the approaches proposed in the three FSB Consultative Documents and to respond in as constructive a way as possible, our ability to do so has been constrained by the very limited deadline for responses to the consultations of under two months (which included the holiday period). The industry would appreciate additional time for dialogue on this issue, in particular since the deadline for FSB agreements is September 2013. In this regard, given the importance of the issue, the originally proposed one month consultation on Money Market Funds (subsequently extended by a further month) was excessively short.

The effect of this short timeframe is counterproductive to the FSB's aims since it reduces the ability of all interested parties – not only the industry but also investors and consumer advocacy groups – to consider the proposed approaches and measures and to provide detailed and constructive responses, including where necessary, coming up with suggestions for alternative approaches that might better deliver the FSB's aims.

We urge the FSB to give these concerns active consideration and in particular, to consider having a further consultation period in June 2013 in which commenters would be able to look at the progress in all the workstreams together to date and comment on the package as a whole, with all policies including workstreams that have been "finalized" on the table. We would also recommend a thorough cost-benefit analysis of the total impact of the proposed reforms, showing that they are indeed the most effective and proportionate way possible of mitigating risks identified.

We hope that if necessary to get policy right, the FSB would be prepared to extend the deadline for agreement beyond September 2013.

We also suggest that in any further work, for instance on an individual non-bank financial activity that emerges as a source of concern about systemic risk, the FSB consider how best to sequence the work and accompany it with cost-benefit analyses.

General Comments on the FSB's Overall Proposed Policy Approach

Given the extensive overlap between the issues in the Integrated Overview document and those in the OSBE paper, and given that it does not seem to make sense to have a separate analytical and policy approach to "Other Shadow Banking Entities" as opposed to the entities and activities covered by the other workstreams and the FSB's wider policy, we felt that in responding to the consultation documents tabled, it would be more sensible to address both documents together as representative of the FSB's overall policy approach to shadow banking. We have though provided specific answers to the five sets of questions in the OSBE paper below.

1. Confusion Caused By Dual Focus on Entities and Activities

In both documents and in the FSB's policy approach as a whole, and despite the efforts of Workstream 3 to address this issue, **it is not clear whether the FSB intends to focus principally on financial activities or on financial entities.**

We recognize the difficulties here in that if risks are identified, any risk mitigation tools applied to activities must ultimately be applied to individual entities engaged in the activity. However, at the earlier stage of monitoring and assessment, we believe that the policy should focus primarily on activities rather than the entities which conduct them, and within this policy, on the fundamental risk elements in or intrinsic characteristics of those activities and weaknesses if any in how they are currently regulated.

There are a number of reasons for this conclusion, including that: (a) entities will often carry out a number of activities, some of which may have the potential to create systemic risk, while others may not; an approach that focuses on the entity alone may not distinguish adequately between these different activities; (b) a number of very different entities may be engaged in the same financial activity (e.g. securities lending) so focusing on types of entity would risk different treatment of the same activity; and (c) there is a danger that a focus on entities would create incentives for them to mutate to avoid regulation without changing the underlying risk.

This is not to say that entities should be ignored. Any regulation or laws relating to a financial activity will ultimately have to be applied to entities conducting them in the context of the regulatory structure under which they operate. Regulators should also pay attention to whether there are additional risks from the combination of activities inside a particular entity. We have set out more details on how to take this approach in our June 2012 Paper.

Indeed, the consultative document on securities lending and repo actually provides a very good model of this approach. It talks of applying minimum standards for cash collateral reinvestment "*to all financial entities that are engaged, with or without an agent, in securities lending against cash collateral where the cash collateral is reinvested in a portfolio of assets*". This approach makes it possible to avoid the dual focus on entities and activities because each entity engaging in the activity would be subject to the same rules.

As noted above, a major concern that we have is that **the policy approach is inconsistent and insufficiently coordinated** across workstreams, between the overall approach and that taken to other shadow banking entities, and with the wider financial reform process. To give a further example: requiring Money Market and other funds to hold liquid asset buffers could exacerbate the collateral shortage issue related to new requirements for banks in the context of margin requirements and Liquidity Coverage Ratio (LCR) compliance. The IIF has reservations about the soundness of proposals that Constant Net Asset Value Money Market Funds should be required to carry a liquidity buffer.

2. Problems Caused by Categorizing and Regulating 'Shadow Banking'

Part of the inconsistency of the dual focus on entities and activities seems to come from the desire to make a complete list of shadow banking entities and activities, an approach which we believe is unworkable. This is an area on which we did considerable work while preparing the June 2012 IIF Paper. Although the FSB suggests that the ""shadow banking system" can be broadly described as "*credit intermediation involving entities and activities (fully or partially) outside the regulated banking system*", the emphasis must be put on the word "broadly". Trying to define it in a sufficiently detailed and precise way for the purposes of regulation or legislation is extremely challenging. We were forced to conclude that irrespective of the term used, attempting to come up with a definitive list of "shadow banking activities" is unworkable for a number of reasons:

i. Creating such a list would imply a "one size fits all" approach to a number of very different activities with very diverse characteristics and risks such as monoline insurance, the use of hedge funds, and direct lending to retail borrowers by independent finance companies, and be overly general or blunt.

ii. Whilst in combination with other activities, an activity might result in a system of non-bank financial intermediation involving maturity and liquidity transformation, credit risk transfer or the build-up of leverage, on its own it might only have some of these characteristics and might not present systemic risk.

iii. Whether an activity forms part of a financial intermediation process and creates systemic risk can depend to a large extent on the context within which it takes place. For instance, securities lending can serve both financial intermediation and other market purposes such as generating increased yield. It would be impractical to make a distinction between these uses.

iv. Equally, whether an activity forms part of a financial intermediation process and creates systemic risk can depend on the scale at which it is carried out, which will vary over time. Some activities may present little risk to the financial system if carried out at a low level, but be of systemic relevance if they grow much larger and if the market relies on them. A hardwired list would not be able to pick up these variations. Rather it highlights the role and need for macroprudential oversight of the financial sector as a whole and intervention when these risks have the potential to be systemic.

v. Given that the premise of the term "shadow banking" as noted is that some activities come close to mimicking one or more of the core functions of banks, any definition or list would need to involve a judgment on just how closely an activity would need to mimic a core function to be classified as "shadow banking". The judgment can inevitably be arbitrary. To give an example, even a hedge fund can be theoretically judged to have "deposit-taking" characteristics even though it might offer no guarantee of any investment being redeemed at or above par, and investors cannot redeem their investments on demand. Where exactly would one draw the line between "shadow banking" and "non-shadow banking" and how would one avoid this line being arbitrary? Any line could create incentives for regulatory arbitrage. In relation to this point, the FSB should also be careful about putting an emphasis on the term "bank-like."

We also concluded that there are similar difficulties with attempting to list shadow banking entities instead.

For these reasons, while we understand the initial attraction of the term "shadow banking" or variants such as "non-bank credit intermediation" or "market-based financing" and while we agree that activities that separately or in combination supplant or complement traditional banking activities should be effectively monitored and any systemic risk effectively mitigated, we believe that an exclusive focus on "shadow banking" is not only unworkable, it is also unnecessary and would represent a diversion from the real focus of policy on the mitigation of risk wherever in the financial system it presents itself.

3. The Use of the Full Range of Risk Mitigation Tools

Indeed using the term "shadow banking" creates an implicit assumption that entities carrying out these activities should be subject to prudential regulation similar to that for banks when **prudential regulation may be neither justified nor the most effective and proportionate option.**

Such prudential regulation may be counterproductive to effective policy because it may lead to an excessive focus on just one form of risk (i.e. credit intermediation) as the sole source of non-bank systemic risk and ignoring or failing to spot other forms of risk building up in the system. Equally, there is a risk of encouraging a migration of risk away from those activities caught in the FSB's net towards other potentially less regulated areas. An attempt to separate the shadow banking system from other parts of the financial system or to separate the banking system from the shadow banking system risks would create a sort of financial "Maginot Line", giving the illusion of safety but without comprehensively addressing the underlying risks and without allowing for the future adaptation of the system.

In the June 2012 IIF Paper, we listed a number of other tools in addition to prudential regulation that could be used:

i. Targeted communication of risks to the general public by supervisors and where necessary investor or consumer education;

ii. Improved disclosure of risks by firms to investors;

iii. Improved firm risk management and governance either in entities engaged in the activity or in entities connected to it, including regulated banks;

iv. The creation and adoption of industry-wide standards for entities engaged in the activity outside the prudentially regulated financial sector or in entities connected to it including regulated banks;

v. Conduct of business regulation which could include insisting on effective disclosure, rules on the avoidance of conflicts of interests, rules on the separation of activities within the same firm, where necessary limiting or proscribing the activity altogether, or other forms of conduct of business regulation;

vi. The use of macroprudential tools.

In addition, regulators could also consider a tool addressing market infrastructure.

Use of these risk mitigation tools should be considered on the basis of which is most proportionately yet effectively placed to address the identified risk. We are concerned that instead, in both the Integrated Overview document and the OSBE paper there is a tendency to assume that a comprehensive approach automatically implies the imposition of predominantly prudential bank-like regulation on non-bank financial activities or entities.

Regulation – whether prudential or other – is not the only way to mitigate risk in the system and nor is it necessarily always the most effective. Where possible, policy makers should initially opt for the approach which is least likely to distort markets and undermine benefits, and thus allow less burdensome and market-based solutions to be tested first.

Indeed poorly designed and overreaching regulation may risk inadvertently closing down economically beneficial activities or markets or displacing risks to other parts of the financial system rather than addressing them. In some cases, the risk comes from market irrationality - often provoked by information asymmetry - rather than from a particular activity. In such cases, regulators would be more effective if they addressed the causes of this behavior by encouraging better disclosure to reduce this asymmetry, and also by encouraging investors to better understand and analyze this disclosure so as to make their own informed decisions. Better consumer education will help here.

Only where a less burdensome approach has either been tested and has demonstrably not succeeded or is clearly unlikely to succeed, should policy makers proceed to more aggressive approaches such as (more) regulation. When policy makers consider introducing new regulation, they should always take into account existing regulations and assess the cumulative impact of proposed and existing risk mitigation measures. Indeed, regulators should take account of the substantial changes that have taken place in the market since the financial crisis began, including industry initiatives such as on Prime Collateralised Securities in securitization[2].

A further concern that we have, linked to our observations on the differences between workstreams, is that there is **insufficient cooperation between prudential, conduct of business and other regulators**. In the lead up to the financial crisis, it was not always a lack of regulation but sometimes a disconnect or insufficient coordination between different types of regulation and regulator that contributed to risks. The different consultations on securitization noted above suggest that this disconnect is continuing.

4. The Role of Other Market Participants

One further element missing from any of the papers and from the shadow banking debate as a whole is a **consideration of the role and obligations of other actors in the financial system**: banks, financial market infrastructures (including central counterparties) investors, end-users and the market as a whole.

In our June 2012 Paper, we outlined five responsibilities of banks in terms of: (i) managing their risks effectively; (ii) monitoring risks from financial activities and alerting regulators; (iii) providing related data and information to regulators and supervisors; (iv) engaging with regulators on their assessment of the risks; and (v) working with regulators on the design and use of risk mitigation tools.

Investors also should perform due diligence to understand the products in which they invest. The more sophisticated the investor is, the greater the duty should be. The absence of sufficient due diligence by some institutional investors was an important factor in what happened during the financial crisis in both Money Market Funds and securitization.

We believe that there would be considerable benefit in further work by the FSB or IOSCO on this issue and on the promotion of retail investor financial education to help them properly understand the risks of their investments, to ask appropriate questions and to reach the right decisions.

5. An Alternative Approach to deliver the FSB's objectives

Instead of the current FSB approach, as we suggested in the June 2012 IIF paper, we believe that there is a more effective approach to monitor, assess and mitigate credit intermediation risks from the shadow banking system, as well as risks emerging in the financial system as a whole.

[2] See page 41 of the June 2012 IIF Paper

Such an approach would be to focus on non-bank financial activities with the potential to create systemic risk and combine an analysis of the risks from these activities with a macroprudential view of the risks to the system as a whole. It would be based on three stages of action:

i. The identification of activities which might be judged *a priori* to be emerging sources of systemic risk and the collection of sufficient information to allow informed judgments;

ii. The understanding of those activities and an assessment of 1) whether they pose potential systemic risks separately, in combination inside entities and/or in their context in the wider financial system and 2) whether the risks posed by these activities are currently sufficiently mitigated;

iii. Where risks are identified that are not sufficiently mitigated, selection of the most proportionate yet effective application of risk mitigation tools such as those suggested above.

Such an approach would therefore be based on a mix of:

i. **Macroprudential oversight** of the entire financial system to detect emerging risks, and monitoring the connections between and within both bank and non-bank financial activities; and

ii. A coordinated **case-by-case international approach** to the mitigation of risks from individual activities, in recognition of the potential cross-border effects of these.

By taking this approach, policy makers would inherently include those activities that could play a role in credit intermediation but would also include any non-bank financial activity creating systemic risk in other ways. This approach would also facilitate the targeted approach and promote the "*resilient system of non-bank credit intermediation*," and would be "*proportionate to financial stability risks, focusing on those activities that are material to the system*", all of which the FSB aims at.

Indeed, this approach is consistent with the approach taken in two of the workstreams – on securitization as well as securities lending and repo. While we do not agree with all the recommendations made, the approach taken by the Task Force on Workstream 5 on securities lending and repo is a model that should be followed for other activities, in terms of attempting to understand the activity, assessing whether there are risks that are not yet being effectively regulated and then proposing risk mitigation. It would be far more effective than the "one size fits all" approach adopted in the OSBE paper.

This approach is also consistent with that taken by the Dodd-Frank Act and the US Financial Stability Oversight Council (FSOC) which look at all non-bank financial activities that could create systemic risk rather than just looking at "shadow banking".

It would also help address a further concern that we have with the two documents: that **both appear to be largely backward-looking** and focused on those activities in the past that were a source of problems during the financial crisis rather than being adaptable to new forms of risk. In particular, the economic functions model set out in the OSBE paper is limited to those functions that were a source of problems rather than allowing a macroprudential assessment of risks from wherever they may originate.

While we agree with the principles listed in the October 2011 FSB Report – i) focus, ii) proportionality, iii) being forward-looking and adaptable, iv) effectiveness and v) assessment and review – and believe that this approach should apply to the design and implementation of risk mitigation tools for both the non-bank and banking system, **we do not believe that the approach currently adopted both in the Overview document and the OSBE document fully meet or are consistent with them**.

Specific Comments on the Other Shadow Banking Entities Paper

With respect to Workstream 3 on other shadow banking entities, we are concerned that the framework proposed would effectively lead to a "one size fits all" approach to non-bank financial activities irrespective of whether they are systemically risky in the first place. We are also concerned that regulation is seen as the only solution rather than considering the range of tools available.

On the specific questions in the OSBE paper on Workstream 3:

Q1. Do you agree that the high-level policy framework effectively addresses shadow banking risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) posed by non-bank financial entities other than MMFs? Does the framework address the risk of regulatory arbitrage?

We agree that "*authorities should cast the net wide, looking at all non-bank credit intermediation*" although as stated above, we believe that authorities should cast the net even wider, looking at all non-bank financial activities as part of their macroprudential assessment of potential and actual risks.

The overarching principles are good as a general guideline, but the framework seems to be so general that we are concerned that it is likely to serve only as guidance rather than having practical use in addressing the best and most proportionate option.

Further, as we explain below, the suggested economic function approach might actually prevent authorities from detecting some of these risks. We therefore believe that while the economic functions are useful as a list of some of the questions that authorities should ask themselves in assessing these risks, they should not be the only ones.

We are also concerned that the list of functions will be interpreted in a hard and fast way, with authorities attempting to divide activities into separate boxes and treat all activities within that box in the same way, ignoring the variety and diversity of the activities.

We are concerned that the regulatory proposals could end up weakening the financial system rather than strengthening it. We provide more details under Question 4 below.

In line with our general comments above, the document does not pay sufficient attention to the issue of interconnectedness. Regulators need to know a lot more about the issue, including the linkages between banking and non-bank financial activities, keeping in mind that regulatory measures or other risk mitigation tools may already be in place to deal with risks from these connections.

Linked to the case-by-case approach that we suggest above, we recommend that regulators should also be attentive to regulatory consistency across similar activities and avoid a cliff effect between regulation in one area and a lower level of regulation in another. This also links back to our observations about the need for better coordination between regulators of all types and a stronger governance process in the FSB on these issues.

Q2. Do the five economic functions set out in Section 2 capture all non-bank financial activities that may pose shadow banking risks in the non-bank financial space? Are there additional economic function(s) that authorities should consider? If so, please provide details, including the kinds of shadow banking entities/activities that would be covered by the additional economic function(s).

We welcome the principle of an activity-based approach which is similar to that advocated by the IIF. However in practice the FSB's approach still ends up as an entity-based approach because the FSB is trying to categorize and list "shadow banking entities", which can be arbitrary as we explained in our June 2012 paper. Moreover, the toolkits are all entity-targeted.

We are also skeptical about the practicality and effectiveness of the economic-function approach because in many cases, it is difficult to categorize an activity into a single economic function. Many activities take place in conjunction with other activities and it is unclear how the FSB's proposed approach would deal with this. The risk is that an entity carrying out more than one function might be subject to a multitude of different and possibly contradictory rules and requirements.

Further, we think that it would be very difficult to use the approach in practice because of the difficulty of determining a boundary between activities that are caught within the economic function and those that would fall outside. For instance, with Economic Function 1, "*Management of client cash pools with features that make them susceptible to runs*", how exactly would authorities determine when a client cash pool had a feature that was susceptible to runs and when it was not? The problem is that while it is possible to list activities that might fall under one or more of these economic functions to some extent, and to state that a list might include a certain activity, regulation or risk mitigation that attempts to use this approach will have to decide to what extent and come up with a complete list, which runs the risk of being arbitrary.

In the same vein as our concerns about excessive focus on non-bank credit intermediation risks over other forms of non-bank financial activity, there is also a danger that the hard and fast approach to categorizing types of risk or economic functions proposed in the OSBE paper and regulating them would lead to risks migrating elsewhere or regulatory arbitrage. SEC Commissioner Luis Aguilar recently commented in a statement, "*Given the level of transparency and investor engagement in regulated, transparent money market funds* *subject to Rule 2a-7 (the principal rule governing money market funds), it remains a concern that assets could flow to unregulated, opaque funds*."

As noted above, the approaches across the workstreams are not consistent. For example, on MMFs, IOSCO came up with number of tools that are not included in the FSB's overarching principles or toolkit for Economic Function 1. There are also contradictions between the approaches to securitization in the OSBE paper and the IOSCO approach.

Beyond these concerns about the framework and general approach and the difficulties of using the five functions as a whole, we also have concerns about individual aspects of each of the five functions.

Bullet 1 in the section on Economic Function 1 - **the management of client pools with features that make them susceptible to runs** – addresses "*Investment funds whose investment objective provides investors with an expectation that their investment will not lose value*". How would you judge this assumption by investors in practice? How would you determine that an "expectation" had been created by an investment objective? What would constitute an "expectation" provided by the investment objective? If an investment objective provided for low risk investment, would this objective create an expectation that an investment might not lose value, even if the investment objective or accompanying disclosure made it clear that "low risk" was not the same as "no risk"? We are sure that the FSB would agree that the existence of an "expectation" by the investor would not be enough to satisfy this since it would be difficult to determine whether the expectation was due to the investment fund objectives, the disclosure documents and accompanying materials provided by the fund provider, the marketing materials for the fund, the role of any market intermediary such as an investment advisor or the failure of the investor themselves to carry out proper diligence and thus an unwarranted unrealistic expectation. Should the fund be penalized even though they had clearly disclosed that the investment did not constitute "no risk"?

There are similar problems with bullet 2: "*Credit investment funds (or mutual funds or trusts) with external financing or substantial concentrated counterparty exposure*". How would regulators be able to detect when a fund was leveraging itself through short-term funding from banks or securities lending rather than carrying out securities lending for normal purposes of managing cash flow? How does the treatment of this economic function sit with the approach taken in Workstream 5 on securities lending and repo?

In bullet 3, how would regulators determine whether a credit investment fund "*in the aggregate held a concentrated position in a particular segment of the credit markets*"? How would this be monitored and would such monitoring and the regulation of such a fund be consistent with the aim of proportionality given that there could only be problems "under extremely adverse credit market conditions"?

A further question for Economic Function 1 is how the distinctions made and the regulations prescribed fit with the work of IOSCO on collective investment schemes or with the European Undertakings in Collective Investments in Transferable Securities (UCITS) regime.

Economic Function 2 – **loan provision that is dependent on short-term financing** – is even more problematic since it conflates four distinct types of entities with characteristics that are very different from each other. It would not make sense to treat these entities in the same way.

Bullet one – "*Deposit-taking institutions that are not subject to bank prudential regulation*" - is unclear. It appears to be talking about deposit-taking institutions that neither operate a payment system nor engage in lending. As such, such institutions create risks that clearly need to be mitigated if not already, but such risks will not be identical to those of a bank.

In contrast, bullet two deals with the opposite side of the equation: finance companies whose funding is highly dependent on wholesale funding markets or short-term commitment lines from banks. We agree that there is systemic risk because of the mismatch between liability and asset duration, and we would agree that the risks here need to be mitigated to the extent that they are not being already. However the nature of the risk and the means of addressing that risk is different from a purely deposit-taking institution described in bullet one because of the presence of loans.

Bullet three however covers an entirely different type of entity: *finance companies that are dependent on funding by parent companies in sectors that are cyclical in nature and/or are highly correlated with the portfolios of the finance companies*. This is different because the parent company provides the funding for the loan from its own profits/ excess cash. This acts as an investment rather than the loans described in bullet two. It is difficult to see how it can create systemic risk since all that would happen if the loans were to go bad is that the parent company would make a loss and at worst would no longer be able to fund new loans.

It is unclear how regulators would judge in practice that a finance company is dependent on funding from banks "*that use these companies as a means to bypass regulation/ supervision*" in bullet four. How exactly would this be determined? How would policy here fit with the work of Workstream 1?

Economic Function 3 – **intermediation of market activities that is dependent on short-term funding or secured funding of client assets** - is also unclear to us. As with Economic Function 2, how would regulators determine in practice whether a securities broker-dealer's funding was dependent or heavily dependent on various types of funding? How would you separate prudent use of securities lending or repos from that that would create leverage leading to systemic risk? How would such treatment sit with the current regulation of broker-dealers both by conduct-of-business regulators and by self-regulatory organizations such as FINRA in the United States?

There are similar issues with Economic Function 4 – **facilitation of credit creation**. As with Economic Function 2, this appears to conflate very different types of activity with very different forms of risk. It is also not clear how much many of these activities still exist. We are also unclear as to how the approach set out here meshes with the ordinary regulation of insurance activities and insurance firms.

We were also puzzled by the sentence "*Credit rating agencies also facilitate credit creation but are outside the scope as they are not financial entities*." How does this fit with the functional approach prescribed? What this illustrates is not so much that credit rating agencies should be included in the approach as the inherent difficulties with setting boundaries and coming up with definitions or lists of "shadow banking entities or activities". It is precisely these difficulties that lead us to believe that a more sensible and effective approach is to look at individual non-bank financial activities and whether they can create systemic risk as part of a macroprudential assessment.

Finally, as noted above, it is unclear why securitization was included under Economic Function 5 and why a different approach was adopted to that in the work by IOSCO.

What this all points to in our view is that while the 5 economic functions are good ***general*** questions to ask as part of an assessment of whether a particular activity poses systemic risk, they do not work for the purposes of categorization or of developing tools for the mitigation of any risks. They also run the risk that regulators will damage perfectly safe activities and ignore other risky activities that might emerge elsewhere.

For this reason, we believe that the approach that we have outlined above of identifying individual activities that might pose systemic risk – and that the FSB has followed in the workstreams on securities lending and repo – represents a much more effective approach and should be applied to other individual activities. (The work by the Bank of Canada on the potential systemic risk from parts of the commodity markets is a good example of the kind of approach that should be taken.)

Q3. Are the suggested information items listed in the Annex for assessing the extent of shadow banking risks appropriate in capturing the shadow banking risk factors? Are there additional items authorities could consider? Would collecting or providing any of the information items listed in the Annex present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

As noted above, we do not agree with the approach of trying to group disparate activities under one or even five headings. This applies equally to the collection of data. We think instead that when carrying out the overall macroprudential oversight of the system and when assessing individual activities, regulators and supervisors should ask themselves whether they have sufficient data and information and if not, look to obtain it in the most efficient manner possible and communicate it to other macroprudential authorities, national regulators and the industry. As also noted above, we are concerned that there is insufficient communication and coordination between different types of regulators.

As we recommended in our June 2012 paper, "*There should be a clear and stated understanding though that specific ad hoc data requests will only be issued where there is a reasonable a priori case for judging that there may be a source of systemic risk and that its collection is not an automatic precursor to regulation*."

Q4. Do you agree with the policy toolkit for each economic function to mitigate systemic risks associated with that function? Are there additional policy tool(s) authorities should consider?

Despite affirming the principle of proportionality, in practice this principle has not been applied effectively in the development of the policy tools. We are concerned that there is an automatic recourse to bank-like regulation without considering whether other tools such as improved information gathering and disclosure would be more effective and proportionate. Regulators should try to take more a gradual and nuanced approach and look more closely at the origin of the risk.

We are also concerned that the OSBE paper takes insufficient account of existing regulation or international responses (e.g. in IOSCO on collective investment schemes, or by self-regulatory organizations (SROs) on rules for broker-dealers). The sole exceptions are Tools 7 and 8 on monitoring under Economic Function 2, which are consistent with our monitoring approach. In particular, we welcome the last sentence on Tool 8: "*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*," although there is unfortunately no reference to consideration of non-regulatory tools.

Considering the individual tools, we are concerned that the choice is ill-adapted to the risk.

To give specific examples in each economic function:

I. The proposals under Economic Function 1 fundamentally transform funds into bank-like entities with bank-like regulations rather than preserving the benefits of those funds. The additional costs and limitations on funds, in conjunction with a reduced funding capacity due to limitations on banks to provide funding to those funds, may well have far-reaching consequences, not only for the funds in question, but equally for end users and in particular for pension beneficiaries. It is not clear how these proposals sit with the work of IOSCO or others on collective investment schemes and with existing regulation in this area. It is also not clear why these proposals would be more proportionate and effective than improved disclosure, transparency and rules on the relationship between investors and market intermediaries.

II. Under Economic Function 2, as noted this covers four very different types of activities with different characteristics and risks and even though some of the recommendations might make sense for some of the activities, they do not make sense for all the activities. A case by case approach to individual activities would be needed here, including an assessment of the cumulative effect of different proposals for that activity.

III. Linked to the points made under Question 2 above, it is not clear how the proposals on broker-dealers sit with existing regulation and self-regulation. The proposals seem to be disproportionate to the perceived risks.

IV. On the facilitation of credit creation, there is no evidence of why these proposals are needed or how they fit with existing insurance regulation. They appear to impose bank-like regulation on insurance entities without any consideration as to whether this would be effective or proportionate.

V. With regard to securitization, we again note the inconsistency of approach between the recommendations here, the work of IOSCO, and the work of the Basel Committee. The Basel Committee is already proposing a non-zero risk weight for liquidity facilities to ABCP conduits. This solution, of making the capital required for liquidity (and credit enhancement) facilities commensurate with the risks incurred by the sponsor bank, is preferable to restrictions on maturity and liquidity transformation.

More importantly, there is inconsistency between the proposals here and those being developed in Workstream 1: the inconsistency lies in the fact that Workstream 1 aims to fully consolidate securitization related entities. At the same time, the OSBE paper proposes to eliminate maturity mismatches at the ABCP conduit level. To the extent that the assets held by conduits will be on the balance sheet, the maturity mismatch issues should no longer be considered at conduit level: the LCR and, in future, the Net Stable Funding Ratio (NSFR) applicable to the consolidating bank will already capture the maturity mismatch and liquidity issues arising from the ABCP issuance. With consolidation, the conduit maturity mismatch is no longer relevant.

We also take issue with the suggestion that banks are inclined to use securitization as cheap funding sources. Given new regulations for banks (and for investors in securitization (notably Solvency 2), securitization is highly unlikely to be ´cheap´ in future. Securitization however is crucial to procure alternative and more diversified funding sources, especially for mortgage banks. Further we are concerned that the combination of Workstream 1 (indirect regulation), the OSBE paper, and proposals in the US and in Europe on bank restructuring likely will reduce significantly the investment of banks in private equity. At present, banks procure worldwide 15% of private equity investment. In Europe 43% of banks are committed to the asset class. On the other hand, the importance of private equity in the current climate of bank deleveraging is increasing, especially for the SME segment. The above facts should be carefully weighted when proposing a final rule.

This is a very brief list of examples provided in the time allowed for the consultation. In the event of a further – longer – consultation, we would be able to go into more detail on the problems with specific proposals.

We are also concerned that due to the problems in coordination across different workstreams and with the wider financial reform process, regulators could easily end up addressing the same risk several times with different instruments.

Q5. Are there any costs or unintended consequences from implementing the high-level policy framework in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers to the extent possible.

As we mentioned earlier, categorizing activities would lead to unintended arbitrage and push risks into unregulated opaque activities.

If regulators rush to regulatory tools without consideration of more gradual approach nor analysis of cumulative impact of a pile of regulations on just one activity, it may put an unnecessarily heavy burden on the activity or just destroy it, depriving the financial markets from benefit of the activity, which may lead to unintended financial instability.

Specific Comments on the Monitoring Process and Other Workstreams

On **enhancing monitoring of the shadow banking system** (Section 1.1 of the Integrated Overview document), we agree strongly that "*One of the lessons of this crisis is the need for authorities to establish system-wide monitoring arrangements capable of assessing sources of systemic risks outside the banking system*".

However we are disappointed that in practice, the FSB has not taken such a wide – macroprudential – approach and has instead limited its focus to the shadow banking system. The attempt to list and categorize entities in the OSBE paper is at odds with the above-mentioned lesson from the crisis.

We therefore suggest that rather than a separate exercise devoted to shadow banking carried out by the Standing Committee on Assessment of Vulnerabilities, such an approach would best be carried out by the kind of international financial stability body tasked with promoting macroprudential coordination and identifying emerging risks to international financial stability that we called for in our July 2011 paper "*Macroprudential Oversight: An Industry Perspective*". Such a body would coordinate the work of those bodies such as the US Financial Stability Oversight Council and the European Systemic Risk Board.

Further, and in line with our view on the difficulties with the term "shadow banking", we are skeptical as to the ability to come up with a single global or even national figure for the size of the shadow banking system for two reasons:

i. The difficulty of determining the purpose of activities. How for instance would it be possible to capture data for securities lending used for the purpose of non-bank credit intermediation as opposed to that used for other purposes such as ordinary cash management?

ii. Even if an entity-based approach were used to generate a figure, would the focus be only on those entities engaged in the activity of securities lending, that are recognizably "shadow banks", but not take into account the cash management operations of say, insurance companies or corporates?

Given these difficulties, we believe that a single figure, derived from Flow of Funds data or other data may be meaningless or potentially misleading. Indeed, we see no inherent need to have a national or global figure for shadow banking. What is important is to have data at the right level and as part of a macroprudential overview of risks.

As with our general views on the FSB's proposed approach, we are concerned that there is insufficient attention and analysis on the interconnectedness of the system

On **Workstream 1 on banks' interactions with shadow banks**, it is extremely difficult for us to comment given the lack of detail available.

Nevertheless, linked to our observations about the need for much greater coordination between the FSB workstreams, we are concerned that this workstream duplicates risk mitigation efforts elsewhere and would consequently add an unnecessary further layer of regulation.

In carrying out the identification, assessment and mitigation of risks from non-bank financial activities, regulators should assess where in the chain of activities the risk originates or is greatest, where in the chain the most success could be achieved through risk mitigation tools, and which tool(s) would be most effective.

Linked to the points we made on page 11 on "The Role of Other Market Participants," the most proportionate and effective tool in a particular case might be indirect regulation (i.e. the regulation of a bank or other entity engaging with that activity) rather than directly targeting the activity itself. One example of this is the use of risk retention requirements for banks engaged in securitization.[3]

However this needs to be assessed on a case by case basis for individual non-bank financial activities rather than trying to impose a general "one size fits all" approach for banks' interactions with shadow banking.

Nevertheless if the FSB decides to continue with this workstream, given the views that we have expressed above on the difficulty of coming up with a workable definition of a shadow banking entity or activity, and given our views on the difficulty of attempting to isolate banks from non-bank financial activities, we urge the FSB to act extremely carefully here and to allow sufficient time for any recommendations to be assessed and commented on.

When the enhancements to Basel II, which focused mainly on securitization, came out, the IIF was of the view that the capital rules for securitization must be evaluated and coordinated with all other improvements being proposed for the securitization process by different constituencies (e.g., new ratings requirements; greater transparency; etc.).

The IIF is therefore pleased that the BCBS is consulting on the securitization framework and will be responding to that consultation. We support the overall objective of the BCBS of making the capital requirements for securitization products more risk sensitive, and without significant cliff effects.

[3] Note our reservations though about the limits of indirect regulation on Page 19 of the June 2012 IIF paper.

We are also pleased to note that the BCBS has explicitly acknowledged that there is a balance to be made between mitigating the risk posed by securitization and maintaining its function as an important tool for bank funding and liquidity. The IIF has always emphasized the important role of securitization in global finance.

On **Workstream 2 on Money Market Funds**, we regret the very short consultation process adopted by IOSCO. Initially, interested parties were given just over one month to comment, followed by a belated and insufficiently publicized extension of a further month. On an issue this important, and given the subsequent extension of the deadline for agreement on the overall shadow banking process by a further nine months, we cannot understand why such restrictive deadlines were appropriate. In line with our views on the process above, given this extended deadline, we would urge the FSB to reopen the file and allow a further consultation on MMFs as part of a wider consultation on the entire shadow banking file, including consideration of whether other risk mitigation tools are available that might be more proportionate and effective in addressing identified risks, for example in stressed market conditions. Further, we regret that there was no cost-benefit analysis of the impact of the recommendations.

In contrast on **Workstream 4 on securitization**, we applaud the efforts made by IOSCO both to address the issue of gaps in approaches to securitization between jurisdictions (and in particular between the EU and US) and to consult with the industry. We recognize the extent to which the comments made by the industry, including the IIF, were taken on board in adopting the Final Report. While we still have some reservations on certain aspects of the recommendations, most notably on scenario analysis, we recognize the efforts to allow for a more flexible approach to disclosure that still allows investors to make informed investment decisions.

We particularly welcome the comment on page 50 of the Final Report that "*it will be beneficial if the impact of the recent legislative and regulatory changes in securitisation […] are given time to have their impact assessed before any further (and potentially duplicative) additional regulations are introduced.*" This is an extremely sensible approach and one that should be adopted more widely.

We also support the new work on possible measures "*that could eliminate or reduce the potentially negative effects of differences in securitisation regulation and terminology on cross-border transactions.*"

On **Workstream 5 on securities lending and repo**, as noted throughout our comments, we believe that the approach of considering the risks from a particular activity and looking at how they might best be mitigated, without automatic recourse to prudential regulation, is in many ways a model to be followed in terms of process (though, as with all workstreams, we regret that there was very little time for the industry to comment).

In our case studies on securities lending and repo in the June 2012 IIF Paper, we supported the provision of increased data to illuminate the scale and nature of the repo markets, and greater disclosure and transparency in both markets. As such, we support the general thrust of the recommendations here.

However we also expressed concern at the practicality of introducing a minimum haircut as it "*would not be sensitive to the creditworthiness of the counterparty, meaning that each participant would potentially be treated in the same manner as the least creditworthy counterparty. Hence, there is a danger of imposing inappropriately high haircuts on sound counterparties. Moreover, where one repo counterparty (i.e. the one accepting the collateral) defaults, the other counterparty (i.e. the one that has provided securities as collateral) would suffer a loss at least equal to the haircut imposed. Hence, an inappropriate haircut would artificially increase losses, potentially aggravating stressed market conditions.*"

While we recognize the efforts made to address these concerns, we remain concerned about the proposal and in particular, the idea of a framework of numerical floors for securities financing transactions. A more effective approach would be to ensure enforcement of the standards for calculating prudent haircuts. Such standards already include the requirement to cover at least one stress period so this would minimize procyclical variations.

We are also concerned that there has been no obvious assessment of the cumulative impact of these recommendations.

Conclusion

In conclusion, we very much support the FSB's overall objective of mitigating the potential systemic risk from non-bank credit intermediation and avoiding regulatory arbitrage while preserving the benefits of such intermediation. We also strongly agree with the principles for action set out in the October 2011 FSB Report of focus; proportionality; forward-looking and adaptable; effective; and subject to assessment and review.

However, we are concerned that the policy framework and proposals set out in the Integrated Overview and particularly in the OSBE paper may impede the FSB's ability to achieve its objectives and do not seem compatible with the five principles.

We are also concerned that meeting these objectives and complying with these principles is being made unnecessarily difficult by the current policy process, and in particular an insufficient level of coordination and consistency; the need for a fuller macroprudential understanding of the non-bank financial system; the absence of analysis of the separate and cumulative impact of policy proposals as well as a cost-benefit analysis; and unrealistic deadlines.

Despite these concerns, we firmly believe that an effective and proportionate approach could be delivered in this area by building on the activity-based approach taken on securities lending and repo and adopting the three step approach of identifying, assessing and mitigating systemic risks from non-bank financial activities that we advocate in our June 2012 Paper, and combining macroprudential oversight with a case by case approach to individual non-bank financial activities. Such an approach would involve using all the tools available to mitigate risks rather than relying exclusively on a prudential regulation approach.

We sincerely hope that the FSB and national regulators will accept these well-meant suggestions and comments and that the FSB will take up the suggestion of a further – extensive – consultation on the entirety of the package (including cost-benefit analyses) in Summer 2013.

We would of course like to engage further with the FSB and are ready to answer any questions on the attached papers. If you have any questions, do not hesitate to contact Crispin Waymouth – cwaymouth@iif.com

Yours faithfully,

Edward F. Greene

Attachments:
IIF Paper: "*'Shadow Banking': A Forward-Looking Framework for Effective Policy*", June 2012