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

Dear Sir,

The Central Bank of Ireland ("Central Bank") welcomes the Financial Stability Board's ("FSB") consultative documents published on 18th November, 2012 on Shadow Banking ("Papers"). The Central Bank appreciates the opportunity to respond to the FSB on these important matters and at this point in time.

The financial crisis has emphasised that regulatory authorities need to improve their surveillance and monitoring of financial activities and that no sector (or sectors) should remain in the 'shadows'[1]. In addition, the impact of declining investor confidence in certain less-regulated sectors can have systemic consequences requiring the intervention of public authorities. Therefore, improved data-gathering and certain regulatory reforms are likely to be necessary in order to address the systemic risks posed by shadow banking activity.

As the FSB begins the process to conclude on all its shadow-banking workstreams, (timetabled for September 2013), the Central Bank would like to make some important overarching remarks on the Papers.

- **Need for Global Co-ordination in Shadow Banking Reform**
  The work of the Financial Stability Board ("FSB") in relation to shadow banking spans five workstreams. The Central Bank also notes that while certain workstreams have completed, others are still not completed. Other authorities, in particular the EU Commission and the Financial Stability Oversight Committee, are considering, or have recently made proposals, for reform in certain shadow banking sectors. Given that shadow banking activity

[1] See, for example, FSB paper entitled "The Financial Crisis and Information Gaps", http://www.financialstabilityboard.org/publications/r_110715.pdf

is largely borderless and that the different shadow banking activities which are being explored are all interconnected, there are risks to implementing reforms on either a regional basis which may lead to an uncoordinated and less than harmonious outcome at a global level. To be clear, it is undesirable for either the US or the EU to act on a unilateral basis given the risks of regulatory arbitrage and the potential unintended consequences of such an approach.

- **Framing a congruent approach between the five FSB workstreams**
  There is a great deal of inter-connectedness between the FSB workstreams. The roles of collateral and funding markets underlie all of these workstreams. The Central Bank believes that a full understanding of the impact of these interconnections and the impact of the whole package of proposed reforms is necessary. The impact of these workstreams on other regulatory initiatives (related to bank liquidity, OTC derivatives and market infrastructure) also needs to be assessed.

  The Central Bank would urge the FSB to be more specific in its plans for "timetable-alignment" and to avoid unknown systemic-flows which may result from piecemeal implementation of the agreed recommendations. An incremental approach to implementing recommendations could result in unintended consequences such as substantial capital-market migrations (and hence risk) between jurisdictions.

- **Establishing a high-level policy framework to guide regulatory intervention**
  The Central Bank is greatly encouraged by the approach taken in the consultative document *"Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities".* [2] The Central Bank believes that the current policy debate has lacked a structured policy-development framework such as that set out in the report. Such an approach is more likely to allow for a consistent regulatory response to market evolution. With respect to the aforementioned policy framework, the Central Bank would suggest an addition to the list of 'overarching principles'. As proposed regulatory interventions (beyond that of data collection and monitoring) are intended to influence agent behaviours and the flow of economic activity, we propose that they be subject to a 'regulatory efficacy assessment'. The addition of such a principle is intended to ensure that policy makers focus on the outcomes of the regulatory responses and the need for such outcomes to be consistent with reducing systemic risk.

[2] This supports the Central Bank's previously stated view that any framework for regulatory reform should be directed at economic activity rather than the entities which conduct the shadow banking activity.

- **Money Market Fund Reform**
  The Central Bank of Ireland welcomes the approach of the FSB which seeks to supplement the IOSCO principles with a test for the efficacy of measures to reduce the run-risk in money market funds ("MMF"). However, we are not convinced that introducing safeguards which are '*functionally equivalent in effect to the capital, liquidity and other prudential requirements on banks that protect against runs on their deposits*' will sufficiently mitigate the risk of investor runs for either constant NAV or variable NAV MMFs. In the case of banks, the effects of (i) depositor protection and (ii) lender of last resort support reinforce the additional regulatory requirements of bank capital, liquidity and other prudential controls. Unlike banks, where these measures mitigate the risk of depositor and creditor runs, the Central Bank believes that it is important that additional regulatory measures intended for the MMF industry are subject to a test of whether the probability of an investor-run has been reduced ('an investor-run test').

  The conversion from fixed to floating NAV could itself be assessed under such a test. Given (i) the current levels of MMF investor risk-aversion and (ii) the experiences of US and European money market funds during the financial crisis, the evidence suggest that such a change in valuation policy would not, in itself, be sufficient to reduce the probability of investor runs and would need to be supplemented by other measures. In this regard, the IOSCO proposals to (i) impose gates (in emergencies), (ii) increase asset liquidity (where this has not already happened) and (iii) apply early-redemption penalties is significant.

Finally, the Central Bank supports the work of the FSB in its efforts to monitor the financial system. We believe that improved collection and analysis of data across the financial system is the minimum necessary first step to enable financial authorities to keep track of emerging issues and to take necessary measures when intervention is warranted. The Central Bank fully supports the work of the FSB and stands ready to assist.

Yours sincerely

Gareth Murphy
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Central Bank of Ireland