Shadow banking

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The Committee on Economic and Monetary Affairs adopted an own-initiative report by Saïd EL KHADRAOUI (S&D, BE) following the Commissions Green Paper on shadow banking.

The report welcomes the Commissions Green Paper as a first step towards the stricter monitoring and supervision of shadow banking. It endorses the Commissions approach based on the indirect regulation and the appropriate extension or revision of existing regulation of shadow banking. At the same time, it underlines the need for direct regulation where existing regulation is found to be insufficient.

The Members agree with the Financial Stability Boards (FSBs) definition of the shadow banking system while pointing out that the system is not necessarily an unregulated or illegal part of the financial sector. It underlines the challenge involved in implementing this definition in a monitoring, regulatory and supervisory context, also taking into account the sustained opacity of this system and the lack of data and understanding regarding it.

Mapping of data and analysis: the report insists on the need to collect, at European and global level, more and better data on shadow banking transactions, market participants, financial flows and interconnections, in order to obtain a full overview of the sector.

In this context, the Members support the creation and management, possibly by the European Central Bank (ECB), of a central EU database on euro repo transactions database. Such a database should cover transactions in all currency denominations in order for supervisors to have a full picture and understanding of the global repo market.

The Commission is urged to:

- proceed to the rapid adoption (in early 2013) of a coherent approach for central data collection, identifying data gaps and combining efforts by existing initiatives from other bodies and national authorities, in particular the trade repositories put in place by the European Market Infrastructure Regulation (EMIR);
- submit a report (by mid-2013) covering, but not limited to, the required institutional set-up (e.g. ECB, European Systemic Risk Board (ESRB), an independent central registry), the content and frequency of data surveys, in particular on euro repo transactions and financial risk transfers, and the level of required resources.

Tackling the systemic risks of shadow banking: the Members believe that a fuller overview and better monitoring and analysis will allow the identification both of those aspects of the SB system which have beneficial effects for the real economy and of those raising concerns related to systemic risk or regulatory arbitrage. Once these systemic risks are identified, the Members propose that they should be tackled by an improved monitoring and regulative response, considering the following proposals:

- Stresses that the reports of the Committee on Economic and Monetary Affairs on CRD IV, currently being discussed with the Council, represent an important step in tackling shadow banking in a positive way by imposing capital treatment of liquidity lines to structured investment vehicles and conduits, by setting a large exposure limit (25 % of own funds) for all unregulated entities.

- The distinction between insurance risk and credit risk may be less clear in, for example, credit insurance products. The Commission is invited to review the legislation on banking, insurance and, in particular, financial conglomerates with a view to ensuring a level playing field between banks and insurance companies and preventing regulatory and/or supervisory arbitrage.

- To make bank balances more reliable, the Commission is invited to examine by beginning of 2013 the way to ensure that entities which are not consolidated from an accounting perspective are consolidated for prudential consolidation purposes, so as to improve global financial stability.

- To ensure greater transparency in the structure and activities of financial institutions, the Commission should propose measures on the structure of the European banking sector, taking into account both the benefits and the potential risks of combining retail and investment banking activities.

- Given the importance of the repo and securities lending market, the Commission is invited to adopt measures, by the beginning of 2013, to increase transparency, particularly for clients, which could include a collateral identifier and collateral re-use to be reported to regulators on an aggregated basis, as well as allowing regulators to impose recommended minimum haircuts or margin levels for the collateralised financing markets, but without standardising them.

- The technique of securitisation can have positive effects in risk distribution. However, more transparency is absolutely needed. The Commission is invited to examine the securitisation market with the view of improving the transparency of the market and to come up by beginning 2013 with a legislative proposal to put a cap on the number of times a financial product can be securitized. Further, more steps have to be taken in the direction of more standardisation of securitisation products as well as imposing stricter retention requirements.

- The money market funds play an important role in the financing of financial institutions in the short run and in allowing for risk diversification. However, that some money market funds, in particular those offering a stable net asset value to investors, are vulnerable to massive runs. The Commission is invited to submit, in the first half of 2013, a review of the Undertakings for Collective Investment in Transferable Securities (UCITS) framework, by requiring money market funds either to adopt a variable asset value with a daily evaluation or, if retaining a constant value, to be obliged to apply for a limited-purpose banking licence and be subject to capital and other prudential requirements.

- Exchange Traded Funds (Exchange Traded Funds - ETF) provide benefits by giving retail investors access to a wider range of assets (such as commodities, in particular). However, they carry risks in terms of complexity, counterparty risk, liquidity of products and possible regulatory arbitrage.

The Commission is, therefore, invited to assess and tackle these potential structural vulnerabilities in the ongoing UCITS VI review, taking into account different customer categories (e.g. retail investors, professional investors, institutional investors) and their different risk profiles.