SHADOW BANKING: SOME CONSIDERATIONS FOR MEASUREMENT PURPOSES

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Overview of presentation

1. Introduction
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Introduction

• “Macro-mapping” exercise as recommended by the Financial Stability Board is the most commonly applied framework

• FSB macro methodological framework broadly endorsed at EU level by European Systemic Risk Board (ESRB) Joint Expert Group on Shadow Banking (JEGS) for use of aggregated data

• A relevant issue is the consolidation of shadow banking entities within banking groups

• Other initiatives on shadow banking stress the micro aspects for measurement purpose

• Data gaps and limitation of aggregated data for risk assessment

• Granular data might reduce the information gap
Macro measurement: FSB approach

Practical two-step approach of FSB for monitoring the Shadow Banking System (SBS), implementation (so far) mainly entities-based:

1. Broad measure:
   - “System of credit intermediation that involves entities and activities outside the regular banking system”
   - Approximated by the financial assets of the Other Financial Intermediaries (OFIs) sector plus Money Market Funds (MMFs)

2. Narrowing down the broad measure:
   - “A system of credit intermediation that involves entities and activities outside the regular banking system, and raises i) systemic risk concerns, in particular by maturity/liquidity transformation, leverage and flawed credit risk transfer, and/or ii) regulatory arbitrage concerns”
   - Narrowing down the broad measure by focusing on parts that potentially pose systemic risks; preliminary attempt in 2013 report by filtering out:
     i. Self-securitisation
     ii. Entities not involved in credit intermediation
     iii. Entities prudentially consolidated into a banking group
Macro measurement: JEGS Metrics task force (1/2)

- Comprises the **OFI sector plus MMFs**
- **EU-wide** is estimated to amount total assets to **€34 trillion** (in Q4 2014)
- **Euro area** estimate is **€24 trillion**
- Outstanding amounts nearly **tripled** in the last decade. The **upward trend** goes on in EU and euro area
- **36%** of the EU financial sector
- JEGS Task Force decided **not to apply** the FSB criterion for narrowing down the focus on risks
Macro measurement: JEGS Metrics Data sources (2/2)

- **Flow of funds** data from national accounts
- Monetary statistics under **ECB Regulations**:
  - MMFs (from MFI data)
  - Non-MMF Investment funds
  - Financial Vehicle Corporations (FVCs)
- Statistics collected under **ECB Guideline** (unpublished, incomplete coverage)
  - Securities Dealers (SDDs)
  - Financial Corporations engaged in Lending (FCLs) – Factoring, Leasing, etc.
- Relevance of “**residual**” where no further breakdowns readily available … also affected by statistical changes to OFI sector
- Alternative sources: **Commercial data** providers, public sources
- **Ad hoc surveys** (e.g. SFT survey)
Macro measurement: Methodological and data issues

- **Excluding all consolidated entities in banking groups** may be subject to criticism:
  - regulatory regime may not be so stringent compared to “regular” banking system and national differences regulation and licences in some cases may not fall within the scope of credit institutions

- **Data Issues:**
  - The “**residual**”- remaining part of OFI sector not broken down by detailed balance sheet statistics- is significant and it is estimated to be **37%** of OFIs.
  - **Aggregated data** are for the macro assessment and are **not based on risk framework**; National Accounts data are not cross-border consolidated, while shadow banking has relevant component in transferring the risk cross borders
  - **Data gaps** for the construction of risk metrics, as concluded by ESRB assessment: some activities e.g. on liquidity transformation are still missing; also data covering S.126 and S.127, SDDs and FCLs are not are not yet available and publishable for the euro area
European Banking Authority (EBA) guideline for data collection on banking large exposures to shadow banking:

- **Absence of a definition** in EU Capital Requirements Regulation (CRR) of terms ‘shadow banking entities’, ‘banking activities’ and ‘regulated framework’, for the Guideline the EBA defines shadow banking entities as entities that are:

  1. **carrying out credit intermediation activities**, defined as bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities; and

  2. **not within the scope of prudential consolidation**, nor subject to solo prudential requirements under specified EU legislation (or equivalent third country legal frameworks)

- As regards **investment funds**, EBA considers that they should fall within the scope of the definition of shadow banking entities for the purposes of these Guidelines, as in the approach of the JEGS
Perimeter of SB might depend on different scope - accounting and regulatory perimeter

IFRS 10 defines the **principle of control** and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements.

New definition of **control**: “An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

IFRS also sets out the accounting requirements for the preparation of **consolidated** financial statements.

One important consequence is that, where a bank has risk exposure (e.g. reputational risk) but **no power to direct the activities of the entity**, it is **not** consolidated for accounting purposes (although separate disclosure requirements exist).
Aggregated data points to some limitations for a measurement of the shadow banking also for micro perspective:

- **Entities outside the accounting scope**, might imply further reduction of information not captured by the available aggregate statistics
- Aggregated data will not be able to capture the changes of the allocation of entities between the accounting and regulatory perimeter
- In this respect, also a recent ECB survey failed to assess the quantitative difference between the accounting and regulatory perimeter with the aggregated data
- Importance and potential usefulness of granular and supervisory data has started to be stressed by the international community
Micro macro approach: Granular data

- Recently the U.S. OFR (Office for Financial Research) and FED in understanding the uses of short term funding and related markets (broker–dealers), linking quarterly data with more granular and frequent data sources and increasing coverage of financial activity represented

- Furthermore, central banks (e.g. Central Bank of Ireland) have started using granular data on financial vehicle corporations (FVCs), money market funds (MMFs) and investment funds (IFs)
  - This bottom-up approach facilitates the classification of entities engaged in shadow banking activities – any top-down definition inevitably excludes entities that engage in shadow banking and/or includes some that do not.

- Granular data for other OFI sector for investment fund sector coming from the AIFMD data base, will lead to enhanced data for leverage
- Micro data available for the SSM, might shed some light on the entities consolidated and the related prudential requirements
• **Non-bank financial intermediation** and shadow banking is a complex phenomenon from micro and macro measurement perspective

  – From **macro perspective**, aggregated data might imply some measurements problem due to the data gaps, residuals and lack of risk based framework
  
  – From **micro perspective** the application of accounting standards and the regulatory framework matters for the determination of the relative size of shadow banking, while the current macro data might not be able to capture these aspects.

• As the two dimensions (micro and macro) and the relative measure might diverge, the paper suggests **as a way forward**, to integrate the metrics constructed with aggregated statistical data with the one using granular and supervisory data.