

Andreas Dombret: Challenges in identifying and monitoring risks from non-bank financial entities and how to address them

Introductory statement by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the Symposium on Asian Banking and Finance, San Francisco, 11 July 2016.

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Ladies and gentlemen,

Thank you very much for inviting me to this interesting conference. It is indeed a great honour and pleasure to join this panel.

In my remarks today, I would like to cover two important questions for central bankers and regulators: First, what are the challenges in identifying and monitoring risks from non-bank financial entities? And second, how can we address these challenges?

The global financial crisis has clearly shown that substantial risks to the financial system can emanate from non-bank financial entities. This is usually the case if entities or activities outside the banking system are engaged in credit intermediation, or more generally, perform bank-like business with bank-like risks without being subject to banking regulation.

Without any doubt, the regulatory reforms after the financial crisis contributed to enhancing financial stability first at all by higher capital and liquidity standards and improved international regulatory and supervisory cooperation.

But we have to bear one important aspect in mind: these reforms will only reach those non-banks that are already regulated today such as insurance companies, for instance. And, more generally, tightening regulation might set off a trend to relocate activities to the unregulated non-banks also known as the "shadow" banking sector. This is something regulators have to watch closely.

Without a doubt, shadow banks can become a source of systemic risk, especially when they are highly interconnected with the regular financial system. It is therefore of utmost importance to monitor shadow banks' activities and try to regulate them adequately.

At their 2014 Brisbane summit, the G20 agreed on a new roadmap for regulating the shadow banking sector. Work is being conducted simultaneously by the FSB, the Basel Committee and IOSCO.

One main challenge we face in this area is data gaps. What are the reasons for this lack of data?

Unlike the banking sector, the non-bank financial sector comprises many different entities. These have quite diverse business models, each with different risk implications for the stability of the financial system. Consequently, dedicated "statistics on the non-bank financial sector" are generally not available. In addition, credit intermediation activities tend to form complex credit chains and linkages in the financial system that may combine and propagate risks in previously unexpected ways.

Yet, importantly, the relevance of risk-monitoring in this area had also been severely underestimated before the global financial crisis. This has changed fundamentally. Several global initiatives are dedicated to filling data gaps and are already bearing fruit.

In sum, the monitoring of non-bank entities has been significantly improved not at least as a result of the macroprudential mandate according to the German Financial Stability Act, which enables macroprudential authorities to drive forward systemic risk monitoring.

But besides all those forthcoming, the ambitious reform agenda is far from being completed. In my view, a key task on the way towards transforming shadow banking into resilient

market-based financing is now to identify areas where additional FSB recommendations are needed and where existing recommendations should be fleshed out.

We have to drive this reform agenda with all our efforts especially because challenges remain, however: One important feature of the non-bank financial sector is its extraordinary capacity to innovate. Central bankers and regulators will therefore continuously have to adjust their monitoring efforts to these dynamics.

It is my deepest conviction that when we speak about regulating banks and non-banks, similar activities should be regulated in a similar manner; but differences should be taken into account. It is therefore key to regulate all activities adequately according to their inherent risks while avoiding the creation of opportunities for regulatory arbitrage.

Thank you for your attention.