

FSB publishes policy recommendations on Shadow Banking

The Financial Stability Board (FSB) has published its policy recommendations intended to strengthen the oversight and regulation of the shadow banking system.

The policy recommendations are the culmination of almost three years' work, the FSB having been mandated by the G20 at the November 2010 Seoul Summit, in collaboration with other international standard setting bodies, to develop recommendations to strengthen the oversight and regulation of the shadow banking system. This followed the completion of the new capital standards for banks (Basel III) and reflected the G20 Leaders concern of the potential risk that regulatory gaps may emerge between the banking and shadow banking sectors. The policy recommendations will be considered by the G20 leaders at their meeting in St. Petersburg on 5/6 September 2013.

The FSB has focused on five specific areas – or workstreams – each chaired by an international standard setting body. The reports that have now been issued relate to the workstreams chaired by the FSB and are stated to take into account the responses received on the consultative documents issued in November 2012. The International Organization of Securities Commissions (IOSCO) has already set out final policy recommendations on money market funds (MMFs) and Securitisation in its reports *Policy Recommendations for Money Market Funds* and *Global Developments in Securitisation Markets*. The Basel Committee on Banking Supervision (BCBS) is scheduled to complete its work in relation to Workstream 1 – the crucial area of mitigating the spill-over effect between the regular banking system and the shadow banking system – in 2014.

Policy Reports

The reports that have been published are:

- *An Overview of Policy Recommendations* that sets out the FSB's overall approach to addressing financial stability concerns associated with shadow banking, actions taken to date, and next steps.
- *A Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos* that sets out recommendations for addressing financial stability risks in this area, including enhanced transparency, regulation of securities financing and improvements to market structure. It also includes consultative proposals on minimum standards for methodologies to calculate haircuts on non-centrally cleared securities financing transactions and a framework of numerical haircut floors.
- *A Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* that sets out the high-level policy framework to assess and address risks posed by shadow banking entities other than MMFs.

Further Consultation

Most of the reports issued contained final policy recommendations. However, the proposed minimum standards for methodologies to calculate haircuts on non-centrally cleared securities financing transactions and a framework of numerical haircut floors will be defined in light of further assessments of their potential impact on the financial system. To this end, Annex 2 of the report on *Policy Recommendations to Address Shadow Banking Risks in Securities Lending and Repos* contains a list of questions on these topics for public consultation. The consultation period closes on 28 November 2013.

Implementation

The FSB reports contain *Policy Recommendations* which would then have to be adopted by the regulatory authorities of its members.¹

Implementation will also be monitored in due course as the FSB, in coordination with the relevant standard-setting bodies, intend to monitor the implementation of the finalised policy recommendations.

On-going Work

Most, but not all, of the policy measures have been finalised and are contained in the reports. The FSB will continue to review the progress of the remaining work to develop policy recommendations and report on progress to the G20 in November 2014.

Comment

Participants in both the banking and shadow banking sectors will be digesting the policy recommendations over the coming weeks. Whatever their ultimate impact, obtaining clarity on the policy recommendations, which have been the subject of much discussion over the past three years, will be welcomed. Across the board there has been a desire for a clearer understanding of the regulations, coupled with an uncertainty about their likely impact. In a recent survey conducted to co-incide with a Clifford Chance conference on shadow banking, 39% of non-bank respondees did not know what impact the proposed regulatory changes would have on their business. This compared with 40% in banks. Perhaps not surprisingly, the majority of respondents in both groups thought that increased regulation would have a somewhat negative impact.

Uncertainty and negativity are bad foundations for growth and having some clarity on the future regulatory landscape will be welcome for banks and non-banks alike. It is to be hoped that the FSB recommendations do adequately identify and address the risks to financial stability from shadow banking activities and contribute, as FSB Chair Mark Carney says, 'to diversify the sources of financing of our economies in a sustainable way to contribute to the G20's ultimate objective of strong, sustainable and balanced growth'.

We shall issue a more detailed briefing on the FSB proposals shortly. If you have any questions, please contact Kate Gibbons by telephone on +44 207006 2544 or email at kate.gibbons@cliffordchance.com.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA
 © Clifford Chance 2013
 Clifford Chance US LLP

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh* ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington D.C.

*Clifford Chance Washington has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh.

¹ Argentina, Australia, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Korea, Mexico, Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Switzerland, Turkey, UK and US