P7_TA(2012)0427

Shadow banking

European Parliament resolution of 20 November 2012 on Shadow Banking (2012/2115(INI))

The European Parliament,

– having regard to the Commission's proposals and to its communication of 12 September 2012 on banking union,

– having regard to the G20 conclusions of 18 June 2012 which call for the completion of work on shadow banking in order to achieve full implementation of reforms,

– having regard to its resolution of 6 July 2011 on 'the financial, economic and social crisis: recommendations concerning the measures and initiatives to be taken'[1],

– having regard to the interim report of the workstream set up by the FSB on repo and security lending published on 27 April 2012, and to the consultation report on money market funds (MMF) published by IOSCO on the same day,

– having regard to the occasional paper (No 133) of the ECB on shadow banking in the euro area, released on 30 April 2012,

– having regard to the Commission's Green Paper on shadow banking (COM(2012)0102),

– having regard to the working document of the Commission services of 26 July 2012 entitled 'Product Rules, Liquidity Management, Depositary, Money Market Funds and Long-term Investments for UCITs',

– having regard to the report of the FSB published on 27 October 2011 on strengthening oversight and regulation of shadow banking, in response to the invitations issued by the G20 in Seoul in 2010 and Cannes in 2011,

– having regard to Rule 48 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A7-0354/2012),

A. whereas the concept of the shadow banking system (SB) as defined by the FSB covers the system of credit intermediation which involves entities and activities outside the regular banking system;

B. whereas regulated entities in the regular banking system take part extensively in those activities defined as part of the shadow banking system, and are in many ways interconnected with shadow banking entities;

C. whereas a considerable proportion of shadow banking activity has one leg in the regulated

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1 Texts adopted, P7_TA(2011)0331.

banking sector, and that leg needs to be fully captured by the existing regulatory framework;

D. whereas some elements that fall under the term SB are vital for financing the real economy, and due care should be taken when defining the scope of any new regulatory measure or extension of an existing one;

E. whereas in some cases shadow banking usefully keeps risks separate from the banking sector and hence away from potential taxpayers or systemic impact; whereas, nevertheless, a fuller understanding of shadow banking operations and their linkages to financial institutions and regulation to provide transparency, reduction of systemic risk and elimination of any improper practices are a necessary component of financial stability;

F. whereas in order to shine light on SB it is necessary for any regulation to fully address the issues of the resolvability, complexity and opacity of the financial activities pertaining to it, in particular in a crisis situation;

G. whereas, according to FSB estimates, the size of the global SB system was approximately EUR 51 trillion in 2011, having grown from € 21 trillion in 2002; whereas this represents 25 to 30 % of the total financial system and half of total bank assets;

H. whereas, despite certain potential positive effects, such as enhanced efficiency of the financial system, greater product diversity and increased competition, shadow banking has been identified as one of the main possible triggers or factors contributing to the financial crisis, and can threaten the stability of the financial system; whereas the FSB is calling for enhanced supervision of the extension of shadow banking activities, which raises concerns, (i) regarding systemic risk, especially through maturity and/or liquidity transformation, leverage ratios and deficient credit risk transfer, and (ii) regarding regulatory arbitrage;

I. whereas proposals on shadow banking and on the structure of lenders' retail and investment arms are important elements for the effective implementation of the 2008 G20 decision to regulate every product and every actor; whereas the Commission must examine this area more rapidly and more critically;

J. whereas SB as a global phenomenon requires a coherent global regulatory approach, based on FSB recommendations (to be published in the coming weeks), to be complemented by those of any other relevant national or supranational regulatory bodies;

A. Definition of shadow banking

1. Welcomes the Commission's Green Paper as a first step towards the stricter monitoring and supervision of SB; endorses the Commission's approach based on the indirect regulation and the appropriate extension or revision of existing regulation of SB; at the same time, underlines the need for direct regulation where existing regulation is found to be insufficient in some of its aspects in functional terms, while avoiding overlap and ensuring consistency with existing regulations; calls for a holistic approach to shadow banking, in which both prudential and market conduct aspects are important; notes an increasing shift to market-based funding and retailisation of highly complex financial products; stresses, therefore, that market conduct and consumer protection should be taken into account;

2. Underlines the fact that any strengthening of the regulation of credit institutions, investment

firms and insurance and reinsurance undertakings will necessarily create incentives to move activities outside the scope of the existing sectoral legislation; stresses, therefore, the need to enhance the procedures for the systematic, pre-emptive review of the possible impact of changes to legislation in the financial sector on the flow of risk and capital through less regulated or unregulated financial entities, and to expand the regulatory regime accordingly in order to avoid arbitrage;

3. Agrees with the FSB's definition of the SB system as 'a system of intermediaries, instruments, entities or financial contracts generating a combination of bank-like functions but outside the regulatory perimeter or under a regulatory regime which is either light or addresses issues other than systemic risks, and without guaranteed access to central bank liquidity facility or public sector credit guarantees'; points out that, contrary to what the term might suggest, shadow banking is not necessarily an unregulated or illegal part of the financial sector; 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;

B. Mapping of data and analysis

4. Points out that since the crisis only a few of the practices of SB have vanished; notes, however, that the innovative nature of the SB system may lead to new developments that may be a source of systemic risk, which should be tackled; stresses, therefore, 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;

5. Believes that close international cooperation and the pooling of efforts at global level are absolutely vital for obtaining a holistic view of the SB system;

6. Believes 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; stresses the need for stronger risk assessment procedures and for disclosure and oversight in respect of all institutions presenting a concentrated risk profile with systemic relevance; recalls the commitments made by the G20 at its Los Cabos summit to establish a legal entity identifier system, and stresses the need to ensure the adequate representation of European interests in its governance;

7. Notes that it is necessary for supervisors to have knowledge of the level, at least in aggregate terms, of institutions' repurchase agreements, securities lending and all forms of encumbrance or clawback arrangements; further notes that in order to address this, the report of the Committee on Economic and Monetary affairs on CRD IV, currently being negotiated with the Council, calls for such information to be reported to a trade repository or a Central Securities Depository in order to enable access for, inter alia, EBA, ESMA, the relevant competent authorities, the ESRB, and relevant central banks and the ESCB: also points out that this report calls for unregistered clawback arrangements to be considered as without legal effect in liquidation proceedings;

8. Supports the creation and management, possibly by the ECB, of a central EU database on euro repo transactions database, to be fed by infrastructures and custodian banks to the extent that they internalise repo settlement in their own books; believes, however, that 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; calls on the Commission 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 EMIR; invites the Commission to submit a report (by mid-2013) covering, but not limited to, the required institutional set-up (e.g. ECB, 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;

9. Considers that despite the substantial amount of data and information required by the CRD under the repo reporting obligation, the Commission should investigate the availability, timeliness and completeness of data for mapping and monitoring purposes;

10. Welcomes the development of a Legal Entity Identifier (LEI), and believes that, building on its usefulness. similar common standards should be developed in relation to repo and securities reporting, to cover principal, interest rate, collateral, haircuts, tenor, counterparties and other aspects which help the formation of aggregates;

11. Underlines that in order to have a joined-up global approach for regulators to analyse data and for them to be able to share this with one another in order to take action where necessary to prevent buildup of systemic risk and protect financial stability, it is essential to have common reporting formats based on open industry standards;

12. Stresses, further, the need to obtain a fuller overview of risk transfers by financial institutions, including but not limited to transfers effected through derivative transactions, data for which will be provided under EMIR and MIFID/MIFIR, in order to determine who has purchased what from whom and how the transferred risks are supported; emphasises that it should be an objective to achieve real-time transaction mapping in all financial services and that this is aided by and can be automated via standardised messaging and data identifiers; invites the Commission, therefore, in consultation with the ESRB and international bodies such as the FSB, to include in its report on central data collection the current work on standardised messaging and data formats and the feasibility of setting up a central registry for risk transfers, which should be able to capture and monitor risk transfer data in real time, making full use of data provided under the reporting requirements of existing and future financial legislation and incorporating internationally available data;

13. Believes that bank reporting requirements are a vital and valuable tool for identifying SB activity; reiterates that accounting rules should reflect reality and that ideally the balance sheet should reflect aggregates to the maximum extent possible;

14. Stresses that these new tasks will require a sufficient level of new resources;

C. Tackling the systemic risks of shadow banking

15. Emphasises that some SB activities and entities may be either regulated or unregulated depending on the country; underlines the importance of a level playing field between countries, as well as between the banking sector and shadow banking entities, in order to avoid regulatory arbitrage which would result in distorted regulatory incentives; notes further that the financial interdependence between the banking sector and shadow banking entities is currently excessive;

16. Notes that accurate regulation, evaluation and auditing are currently being made almost impossible where there is distortion of credit risk or disturbance of cash flows;

17. Believes that funds and managers should demonstrate that they are fail-safe and that positions can be properly understood and taken over by another;

18. Underlines the need to improve disclosure of financial asset transfers from the balance sheet by filling the gaps in the International Financial Reporting Standards; stresses the responsibility of financial gatekeepers, such as accountants and internal auditors, in signalling potentially harmful developments and buildup of risks;

19. Believes that accounting rules should reflect reality, and that allowing assets to be valued at purchase cost when this is far above market value has contributed to instability in banking and other entities and should not be allowed; calls on the Commission to encourage changes to the IFRS, with more attention being paid to aggregates without netting and risk weights;

20. Believes that financial regulation should aim to tackle the issues of complexity and opacity in financial services and products, and that regulatory measures such as increased capital charges and removing risk weight reductions have a role to play in discouraging complex derivative hedging; considers that new financial products should not be marketed or approved where they are not accompanied by a demonstration of their resolvability to regulators;

21. Proposes that asymmetry of information should be penalised, especially with regard to documentation and disclaimers attributed to financial services and products; believes that where necessary such disclaimers should be subject to a 'small print' charge (per page per disclaimer);

22. Stresses that the reports of the Committee on Economic and Monetary Affairs on CRD IV[1], 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, which will help in nudging banks towards the Net stable funding ratio, and by recognising the higher risk, relative to regulated and non-financial entities, of exposures to such entities in the prudential provisions for liquidity risks;

23. Notes that one of the lessons of the financial crisis is that whereas there is normally a clear distinction between insurance risk and credit risk, the distinction may be less clear in, for example, credit insurance products; invites the Commission 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;

24. Believes further that the proposed extension of certain elements of CRD IV to certain non-deposit-taking financial institutions not covered by the definition in the Capital Requirements Regulation (CRR) is necessary in order to address specific risks, taking into consideration the fact that some provisions may be adjusted to the specificities of these entities in order to avoid a disproportionate impact on those institutions;

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1 A7-0170/2012 and A7-0171/2012.

25. Takes the view that a European Banking Authority cannot be allowed to exclude the shadow banking sector;

26. Stresses the need to ensure that all SB entities having a bank sponsor or linked to a bank are included in the bank's balance sheet for prudential consolidation purposes; invites the Commission to examine, by the beginning of 2013, means of ensuring that entities which are not consolidated from an accounting perspective are consolidated for prudential consolidation purposes to improve global financial stability; encourages the Commission to take into account any guidance from the BCBS or other international bodies for the better alignment of accounting and risk-based scope of consolidation;

27. Underlines the need to ensure greater transparency in the structure and activities of financial institutions; invites the Commission, taking account of the conclusions of the Liikanen report, to 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;

28. Takes note of the importance of the repo and securities lending market; invites the Commission 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; acknowledges in this context the importance of clearly determining the ownership of securities and ensuring its protection; nevertheless invites the Commission to engage in a comprehensive debate on margins in addition to the sectoral approaches that have already been embarked on, as well as studying and considering the imposition of limits of rehypothecation of collateral; Stresses the need to review bankruptcy law in relation to both the repo and security lending market and securitisations, with the aim of harmonisation and of addressing issues of seniority relevant to the resolution of regulated financial institutions; calls on the Commission to consider various approaches to restricting bankruptcy privileges, including proposals to limit bankruptcy privileges to centrally cleared transactions or to collateral meeting harmonised and predefined eligibility criteria;

29. Believes that incentives associated with securitisation need to be adequately addressed; emphasises that solvency and liquidity requirements for securitisations should promote a high-quality and well-diversified investment portfolio, thereby avoiding herding; invites the Commission to examine the securitisation market, including a review of covered bonds which can increase risks on banks' balance sheets; invites the Commission to propose steps to notably increase its transparency; calls on the Commission to update, where necessary, the current regulation to make it consistent with the new BCBS securitisation framework currently under discussion, at the latest by the beginning of 2013; proposes imposing a limit on the number of times a financial product can be securitised, and particular requirements for suppliers of securitisation (e.g. originators or sponsors) to retain part of the risks associated with securitisation, thus ensuring that retention of the risks really is being retained by the supplier rather than being passed on to the asset manager, alongside measures to achieve transparency; calls in particular for the introduction of a consistent methodology to value the underlying assets and standardisation of securitisation products across different legislations and jurisdictions;

30. Notes that baskets of assets have been repo'd in an 'originate to repo' manner, in some

instances acquiring enhanced ratings; stresses that such transactions should not be used as a regulatory measure for liquidity (see the ECON report on CRD IV);

31. Recognises the important role played by money market funds (MMFs) in the financing of financial institutions in the short run and in allowing for risk diversification; recognises the different role and structure of MMFs based in the EU and the US; recognises that the 2010 ESMA guidelines imposed stricter standards on MMFs (credit quality, maturity of underlying securities and better disclosure to investors); notes, however, that some MMFs, in particular those offering a stable net asset value to investors, are vulnerable to massive runs; stresses, therefore, that additional measures need to be taken to improve the resilience of these funds and to cover the liquidity risk; supports the October 2012 IOSCO final report in its proposed recommendations for the regulation and management of MMFs across jurisdictions; believes that MMFs that offer a stable net asset value (NAV) should be subject to measures designed to reduce the specific risks associated with their stable NAV feature and internalise the costs arising from these risks; considers that regulators should require, where workable, a conversion to floating/variable NAV, or, alternatively, safeguards should be introduced to reinforce stable NAV MMFs' resilience and ability to face significant redemptions; invites the Commission to submit a review of the UCITS framework, with particular focus on the MMF issue, in the first half of 2013, by requiring MMFs 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; stresses that regulatory arbitrage must be minimised;

32. Invites the Commission, in the context of the UCITS review, to explore further the idea of introducing specific liquidity provisions for MMFs, by setting minimum requirements for overnight, weekly and monthly liquidity (20 %, 40 %, 60 %) and to charge liquidity fees upon a trigger which also leads to a direct information obligation to the competent supervisory authority and ESMA;

33. Recognises the benefits which Exchange Traded Funds (ETFs) provide by giving retail investors access to a wider range of assets (such as commodities, in particular), but stresses the risks ETF carry in terms of complexity, counterparty risk, liquidity of products and possible regulatory arbitrage; warns of the risks associated with synthetic ETFs owing to their increasing opacity and complexity, in particular when synthetic ETFs are marketed to retail investors; invites the Commission, therefore, 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;

34. Calls on the Commission to undertake comprehensive impact assessments of the effects of all new legislative proposals on the financing of the real economy;

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35. Instructs its President to forward this resolution to the Council, the Commission and the Financial Stability Board.