



# **Measures of Leverage and Maturity Mismatches in the Shadow Banking System**

**A Stocktaking of G20 Recommendation 4**

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# Recommendation #4

“Further investigation of the measures of system-wide macroprudential risk to be undertaken by the international community. As a first step, the BIS and the IMF should complete their work on developing measures of aggregate leverage and maturity mismatches in the financial system, drawing on inputs from the Committee on the Global Financial System (CGFS) and the Basel Committee on Banking Supervision (BCBS).”

(FSB-IMF Report to the G20 Finance Ministers and Central Bank Governors)

# What is the Shadow Banking System?

- **McCulley Definition** - Levered-up non-bank intermediaries that fund themselves with uninsured short-term funding
- **Broader FSB Definition** – Entities that undertake credit intermediation outside the banking system

For purposes of measuring “system-wide macroprudential risk”, the narrower definition appears to encompass most of the transformations that create macroprudential risk. For instance, entities that engage in “negative duration” (borrowing long and lending short such as life insurers and pension funds) create entirely different sets of risks

# Nature of the Vulnerabilities

The SBS is particularly vulnerable to funding runs during periods of financial distress because of the coincidence of:

- Short-term funding
- Lack of a credible liability backup
- Uncertainties about the quality of assets due to:
  - Opacity and lack of disclosure
  - Limited or non-existent regulatory and supervisory oversight
- Low or even zero level of loss-absorbing capital

Conclusion: Maintaining funding during financial distress episodes depends crucially on maintaining the confidence of the funding provider

SBS deposit runs result in rapid and violent deleveraging that, where the SBS is relatively large, can spill over to systemic bank distress

# Does the SBS Require Different Measures of Macprudential Risk?

## SBS characterized by:

- Disaggregation of financial transformation functions (maturity, liquidity and leverage creation)
- Long chains of intermediation
  - Obscure the incidence of maturity and credit transformation
  - Require particularly extensive information on the chains to capture that incidence
  - Obscure the role of banks in the intermediation and transformation process
- Outside the regulatory and supervisory perimeter
  - Formal information disclosure is minimal
  - Informal informational exchanges are relatively rare

# International Initiatives

- 2010 G20 Seoul Summit – Requested FSB and other international standard setting bodies to develop recommendations to strengthen regulation and oversight of the “shadow banking system” by mid-2011
- FSB Expert Workshop – Dec 2010
- Shadow Banking Task Force (SRC/SCAV)
  - Scoping Note, March 2011
  - Report to FSB Plenary, April 2011
  - Final Recommendations to FSB Plenary, July 2011
- G-20 Information Gaps, Recommendation #4

# Key Issues

- Mapping the SBS – 8 countries engaged in preliminary exercise
- Developing Framework for Measuring Leverage and Maturity Mismatches
- Practical Monitoring Approaches
  - Flow of Funds approach
  - Micro Perspective (quantitative and qualitative)
- Aggregate versus Granular Measures