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# Financial sector regulation

## Shadow banking cannot continue to slip under the radar say MEPs

The European Parliament today adopted a report on shadow banking (1), calling for tougher EU regulation and more transparency from the sector. The Greens have pushed for stricter rules and welcomed the vote, with Green finance spokesperson **Philippe Lamberts** (MEP, Belgium) stating:

*"Despite representing a significant proportion of the activities of the financial sector (2), often higher risk activities, the 'shadow banking' sector has managed to slip under regulators' and policy makers' radars for too long. The EP has today sent a strong political signal to the European Commission and governments on the need to ensure EU rules properly apply to the sector, to clamp down on overly risky practises and to try and shed more light on - what is - a murky industry.*

*"In spite of the significant economic value and risks of the shadow banking sector, many of the entities involved have managed to escape regulations applying to traditional financial institutions. The financial crisis and the interlinkage of 'true banks' and 'shadow banks' has effectively meant the transfer of massive amounts of public funds to these of these un-regulated entities. This situation cannot continue and MEPs have today called for this to be addressed.*

*"In particular, the report calls on the Commission to propose legislation to improve the information on the sector and the risks it poses to the financial system, to ensure more comprehensive regulation of 'shadow banking entities' that is commensurate to their risk, to strengthen rules governing the interaction of true and shadow banking entities and to strengthen the power of supervisors over innovative products (comprehensive list of proposals outlined below - 3)."*

(1) "Shadow banking" is a generic term describing activities economically similar to banking, but performed in entities that are not regulated as banks (e.g. hedge funds). The report adopted by the European Parliament, while non-legislative, calls on the European Commission to present legislative proposals in a number of areas.

(2) According to the Financial Stability Board, the shadow banking sector in the EU is valued at €17 trillion, second only to the US. The assets generated total more than 110% of Eurozone GDP, while representing 370% in the UK and 490% in the Netherlands.
http://www.financialstabilityboard.org/list/fsb_publications/tid_150/index.htm

(3) More comprehensive list of measures proposed:

· setting up centralised comprehensive data and analysis of flows of liquidity and risk within the shadow banking sector and between it and commercial banks

· maximising use of data required under existing legislation and identifying gaps

· ensuring all currencies and the international dimension are catered for

· continuous monitoring of regulatory arbitrage opportunities and their exploitation by both shadow banks and commercial banks

· better accounting standards to capture the risks being shunted around

· a review of standards for collateral including limits on re-using collateral received from others as collateral for ones own funding (rehypothecation)

· a review of securitisation including formal limits on repackaging of securitsation and potentially stricter measures to ensure that originators keep suffiecient "skin in the game" to make sure they do not drop lending standards

· a review of bankruptcy privileges for investors in securitisation products, "repo" instruments and non-centrally cleared derivatives (to ensure that the priority of such claims does not unfairly impact retail clients or taxpayers)

· a review of money market funds in UCITS VI to clearly distinguish and regulate those that compete with bank deposits from those that are short-term and higher risk investment funds

· a proposal for new rules on exchange traded funds, in the light of the fact that they direct huge volumes of speculative capital towards commodity markets with the significant risk of turning them into casinos rather than sensible risk management markets for producers and consumers

· taking account of the Liikanen report on structural reform in the EU banking sector

· a systematic process for anticpating incentives for regulatory arbitrage, especially through the transfer of risks through the shadow banking system, when new legislation for banks is proposed, to avoid the thus far rather ad hoc way in which legislation has caught up with itself to plug loopholes leading to the buildup of systemic risk in underregulated areas of the financial sector.

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**Responsible MEPs**

Philippe Lamberts

Member

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