



Shadow Banking

مصارف الظل

SAMA Quarterly Workshop, Riyadh

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Global Perspectives

Shadow Banking





Global Perspectives

Global Perspectives

A number of international leaders, IOs, and researchers have warned of growing threats of shadow banking to the global economy.

Mark Carney was recently asked to identify the greatest danger to the world economy?

He chose "Shadow Banking" in the EMEs.

China-SB is at 25-35 percent, it is the fifth largest shadow banking sector in the world.

Further tight-reg implementation of will lead to more ac off banks' and insu less-regulated

Risks

Prezi shadow banking,



C. Lagarde - IMF MD





Global Perspectives

The Greatest Threat



Dr Mark Carney, BoE Governor &
FSB Head

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He chose "Shadow Banking" in the EMEs.



Global Perspectives

Ignored Risks



Mr Jaime Caruana, BIS GM

In 2011, warned that shadow banking, which played a key role in the financial tsunami that struck the global economy in 2008, still poses “potential threats to financial stability that must be monitored and checked”.



Global Perspectives

Vigilance needed on Rising Shadow Banking

Further worry is the migration of new market and liquidity risks to the “shadows” of the financial world.

- US SB Larger than Traditional Banking.
- EU-SB is roughly half the size;
- China-SB is at 25-35 percent, it is the fifth largest shadow banking sector in the world.



C.Lagarde -IMF MD



Global Perspectives

An Unintended Consequence

Further tight-regulations as a result of the joint implementation of Basel III and Solvency II accords will lead to more activities being deliberately moved off banks' and insurers' balance sheets, and also to less-regulated sectors (shadow banking).



Gregorio Impavido, IMF Economist



Ahmed Al-Darwish, SAMA



Outlines

- Definitions & Measures
- Size and Growth of Shadow Bank(ing)
- Factors and drivers of SB growth
- Shadow banking and financial stability
- Regulations & some countries' experiences to contain SB's risks.
- Conclusion and Q&A



Definitions

Unregulated or
lightly regulated
bank-like
intermediation

Activities

Bank-like entities
without government
backup or access to
central bank liquidity

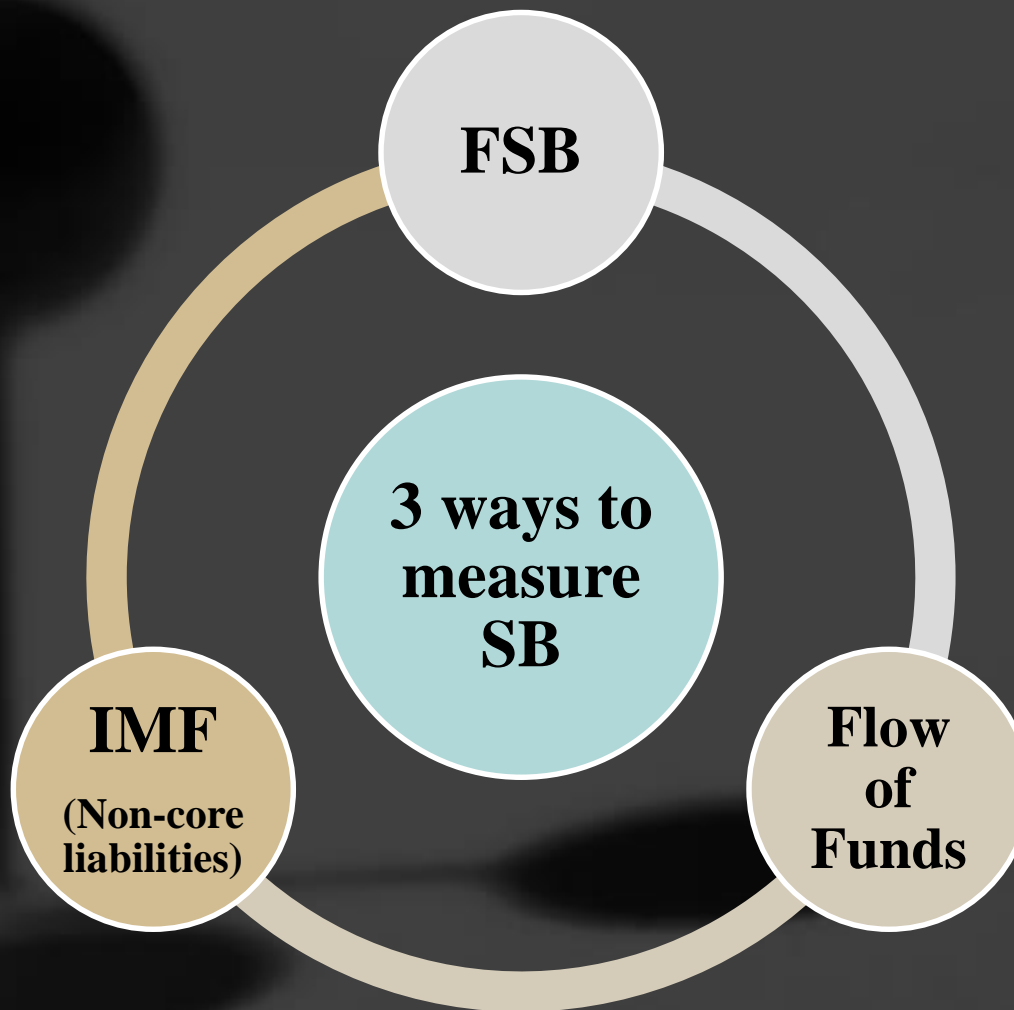
Entities

Credit intermediation
involving entities and
activities outside the
regular banking system

...or both



...& Measures





...& Measures

| | Flow of funds | Financial Stability Board | Noncore liabilities |
|---------------------------------|---|---|--|
| Coverage | Nonbank financial institutions <ul style="list-style-type: none"> Engaged in financial intermediation Providing long-term financing | Nonbank financial institutions <ul style="list-style-type: none"> Engaged in financial intermediation Providing long-term financing | Banks Nonbank financial institutions MMFs |
| | Excludes non-MMF investment funds | Includes non-MMF investment funds | Excludes non-MMF investment funds |
| | Advanced economies Former emerging market economies | Advanced economies Emerging market economies | Advanced economies Few emerging markets |
| Source | Flow of funds statistics Quarterly, long history, starting 1980s | Flow of funds and sector data, FSB Annual, short history, starting 2002 | IFS Quarterly, short history, starting 2001 |
| Entities/ Activities | Money market mutual funds | Money market mutual funds | Narrow measure includes: <ul style="list-style-type: none"> Restricted and nonresident deposits Securities Loans MMF shares/units |
| | Financial leasing corporations | Finance companies | |
| | Securitization vehicles | Securitization vehicles | |
| | Broker/dealers | Broker/dealers | |
| | | Investment funds (bonds, equity, mixed) | |
| | | Hedge funds | |
| | Country-specific entities <ul style="list-style-type: none"> Financial holding corporations Development capital companies Other entities | Country-specific entities <ul style="list-style-type: none"> Financial holding corporations Private development banks Other entities | Broad measure consists of narrow plus the following intra-financial-sector positions: <ul style="list-style-type: none"> Securities MMF shares/units |
| | Venture capital corporations | | |
| | Other (not specified) | | |
| Features | Entity based (narrower entity set) Entity breakdown not always available Balance sheet breakdowns available Somewhat more country specific | Entity based (broader entity set) Broad and narrow measures No balance sheet breakdowns More cross-country consistency Not publicly available Data more subject to valuation effects (due to importance of investment funds) | Entity and activity based Broad and narrow measures No balance sheet breakdowns Somewhat country specific Relates to financial fragility literature Captures shadowy banking activities |

Source: IMF staff.

Note: FSB = Financial Stability Board; MMF = money market mutual fund; IFS = IMF, International Financial Statistics database.

Source: GFSR, Oct 2014, IMF



...& Measures (Flow of Funds)

| | Flow of funds |
|---------------------------------|--|
| Coverage | <p>Nonbank financial institutions</p> <ul style="list-style-type: none"> Engaged in financial intermediation Providing long-term financing <p>Excludes non-MMF investment funds</p> <p>Advanced economies Former emerging market economies</p> |
| Source | <p>Flow of funds statistics Quarterly, long history, starting 1980s</p> |
| Entities/ Activities | <p>Money market mutual funds</p> <p>Financial leasing corporations</p> <p>Securitization vehicles</p> <p>Broker/dealers</p> <p>Country-specific entities</p> <ul style="list-style-type: none"> Financial holding corporations Development capital companies Other entities <p>Venture capital corporations</p> |
| Features | <p>Entity based (narrower entity set) Entity breakdown not always available Balance sheet breakdowns available Somewhat more country specific</p> |

Source: GFSR, Oct 2014, IMF



...& Measures (FSB)

| | Financial Stability Board |
|---------------------------------|--|
| Coverage | Nonbank financial institutions <ul style="list-style-type: none"> • Engaged in financial intermediation • Providing long-term financing Includes non-MMF investment funds |
| | Advanced economies Emerging market economies |
| Source | Flow of funds and sector data, FSB Annual, short history, starting 2002 |
| Entities/ Activities | Money market mutual funds Finance companies Securitization vehicles Broker/dealers Investment funds (bonds, equity, mixed) Hedge funds Country-specific entities <ul style="list-style-type: none"> • Financial holding corporations • Private development banks • Other entities |
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| Features | Entity based (broader entity set) Broad and narrow measures No balance sheet breakdowns More cross-country consistency Not publicly available Data more subject to valuation effects (due to importance of investment funds) |

Source: GFSR, Oct 2014, IMF



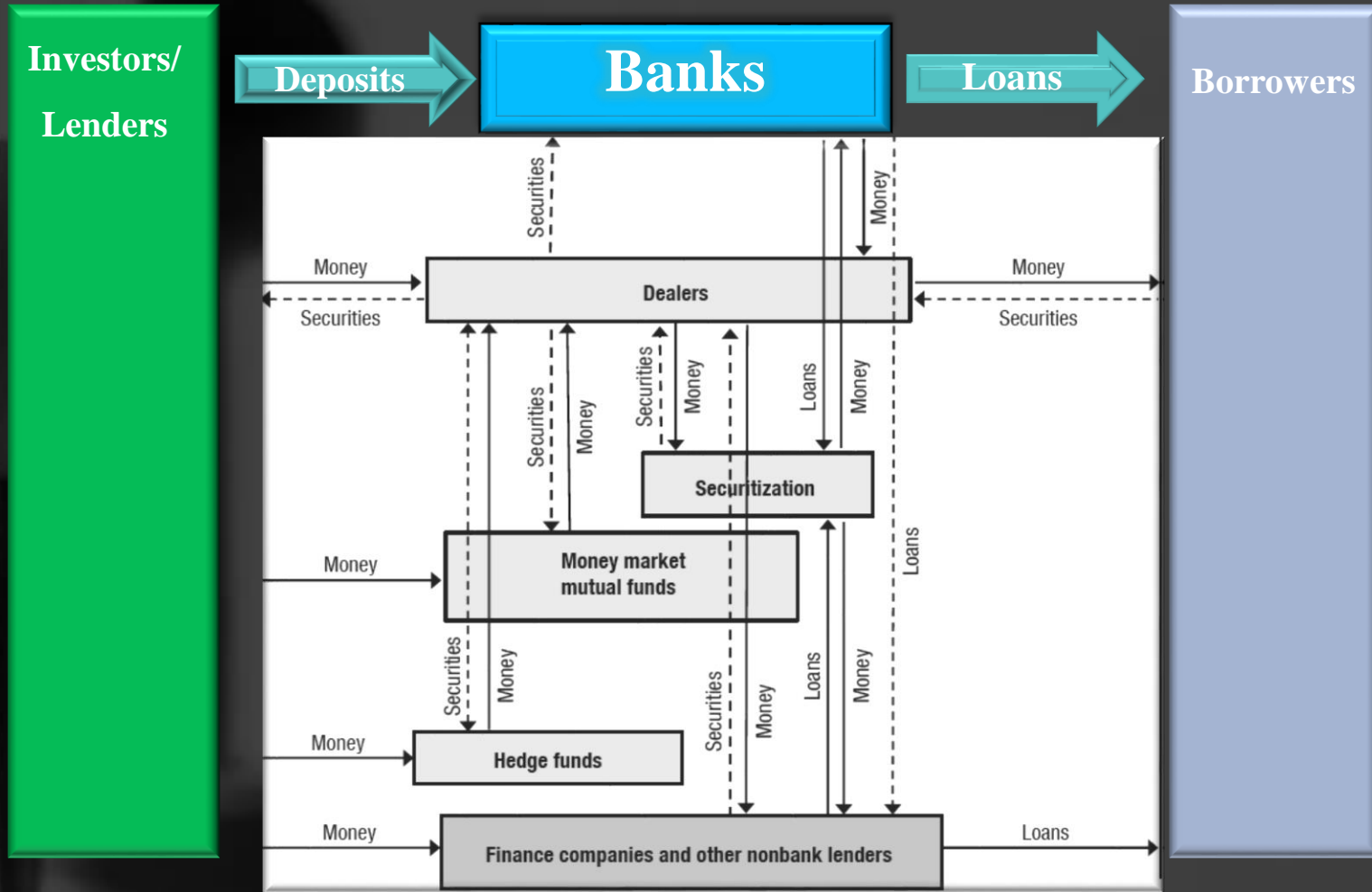
...& Measures (IMF)

| | |
|---------------------------------|--|
| | Noncore liabilities |
| Coverage | <p>Banks Nonbank financial institutions MMFs</p> <p>Excludes non-MMF investment funds</p> <p>Advanced economies Few emerging markets</p> |
| Source | <p>IFS Quarterly, short history, starting 2001</p> |
| Entities/ Activities | <p>Narrow measure includes:</p> <ul style="list-style-type: none"> • Restricted and nonresident deposits • Securities • Loans • MMF shares/units <p>Broad measure consists of narrow plus the following intra-financial-sector positions:</p> <ul style="list-style-type: none"> • Securities • MMF shares/units |
| Features | <p>Entity and activity based Broad and narrow measures No balance sheet breakdowns Somewhat country specific Relates to financial fragility literature Captures shadowy banking activities</p> |

Source: GFSR, Oct 2014, IMF



...& Measures



Source: GFSR, Oct 2014, IMF



Some Specific Risks of Shadow Banking

Run Risk

Such risk is usually greater in SB, due to absence of formal backstops or prudential standards

Opacity & (de-)Leverage

During stress periods, **Investors** tend to retrench and flee to quality and seek more transparency

Spillovers

In good times, shadow banks may contribute substantially to asset price bubbles, as less-regulated entities



Some Specific Risks of Shadow Banking

BUT, Is Shadow Banking a bad thing?

1. SB can complement traditional banking by expanding access to credit
2. Support market liquidity
3. Help in maturity transformation
4. ...Risk-Sharing



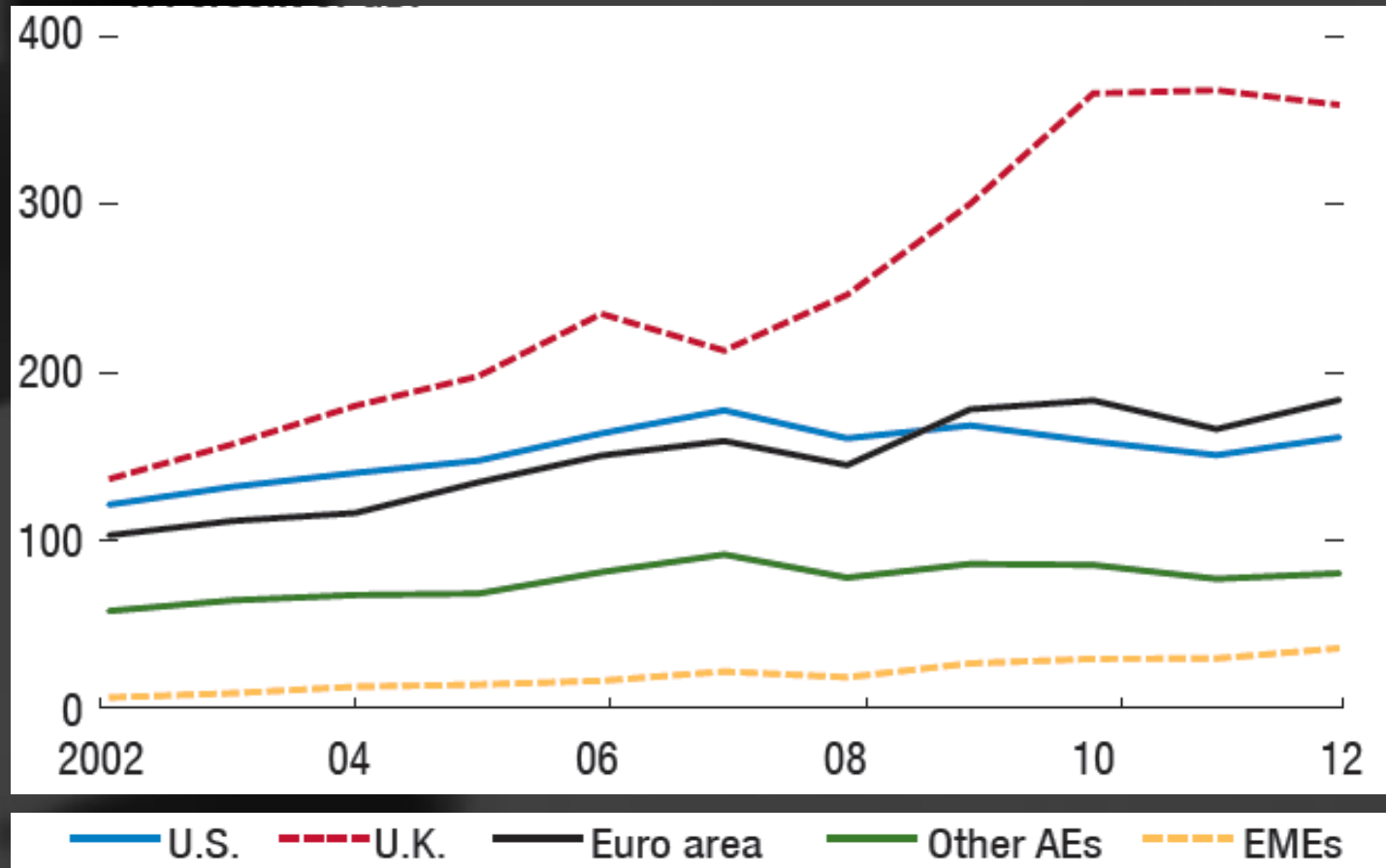
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Size and Growth of Shadow Bank(ing)

Shadow Banking Growth (Percent of GDP)

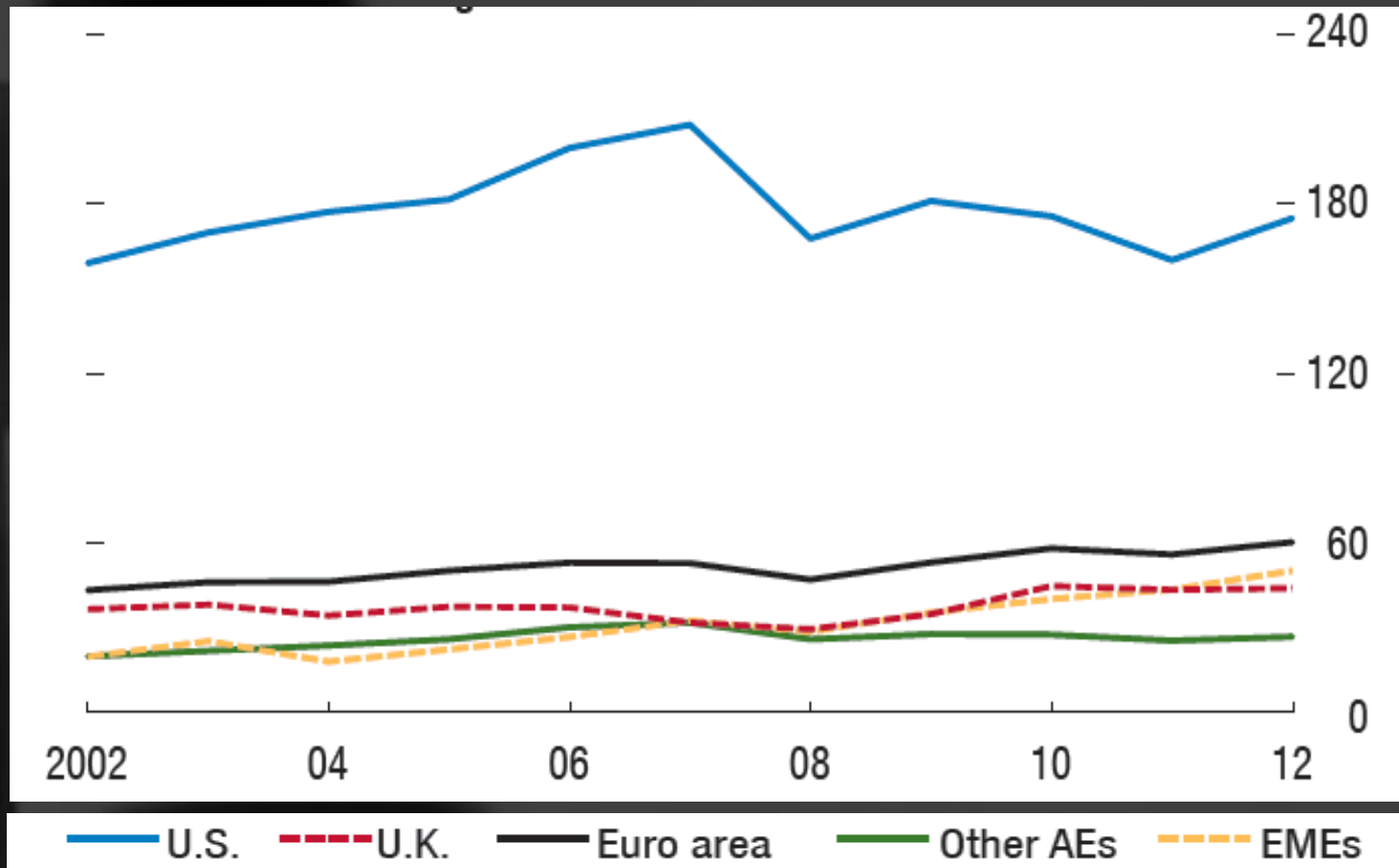


Source: GFSR, Oct 2014, IMF



Size and Growth of Shadow Bank(ing)

Shadow Banking Growth (Percent of Banking Assets)

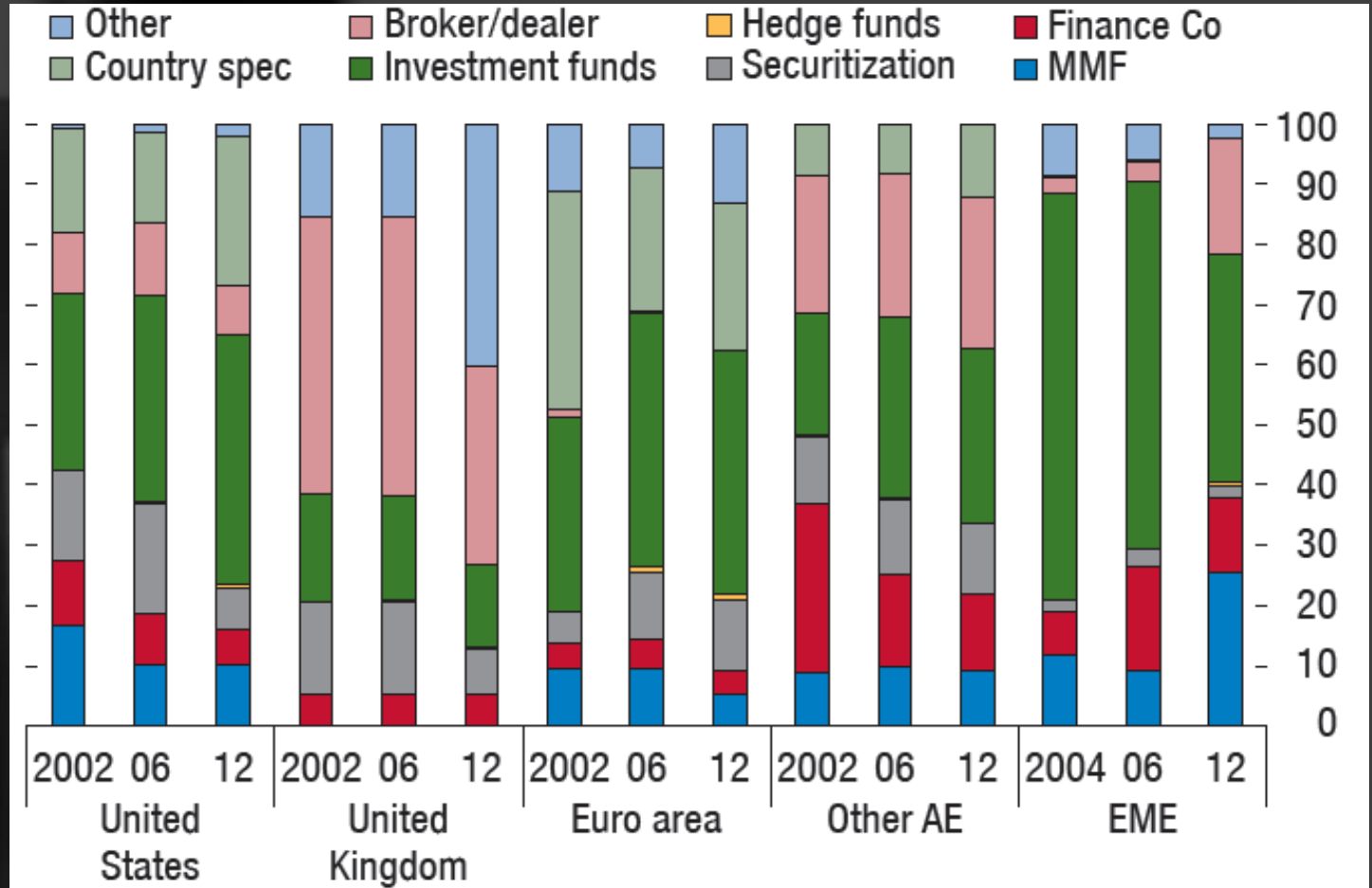


Source: GFSR, Oct 2014, IMF



Size and Growth of Shadow Bank(ing)

Breakdown by Subsector (Percent of entities' financial assets)



Source: GFSR, Oct 2014, IMF

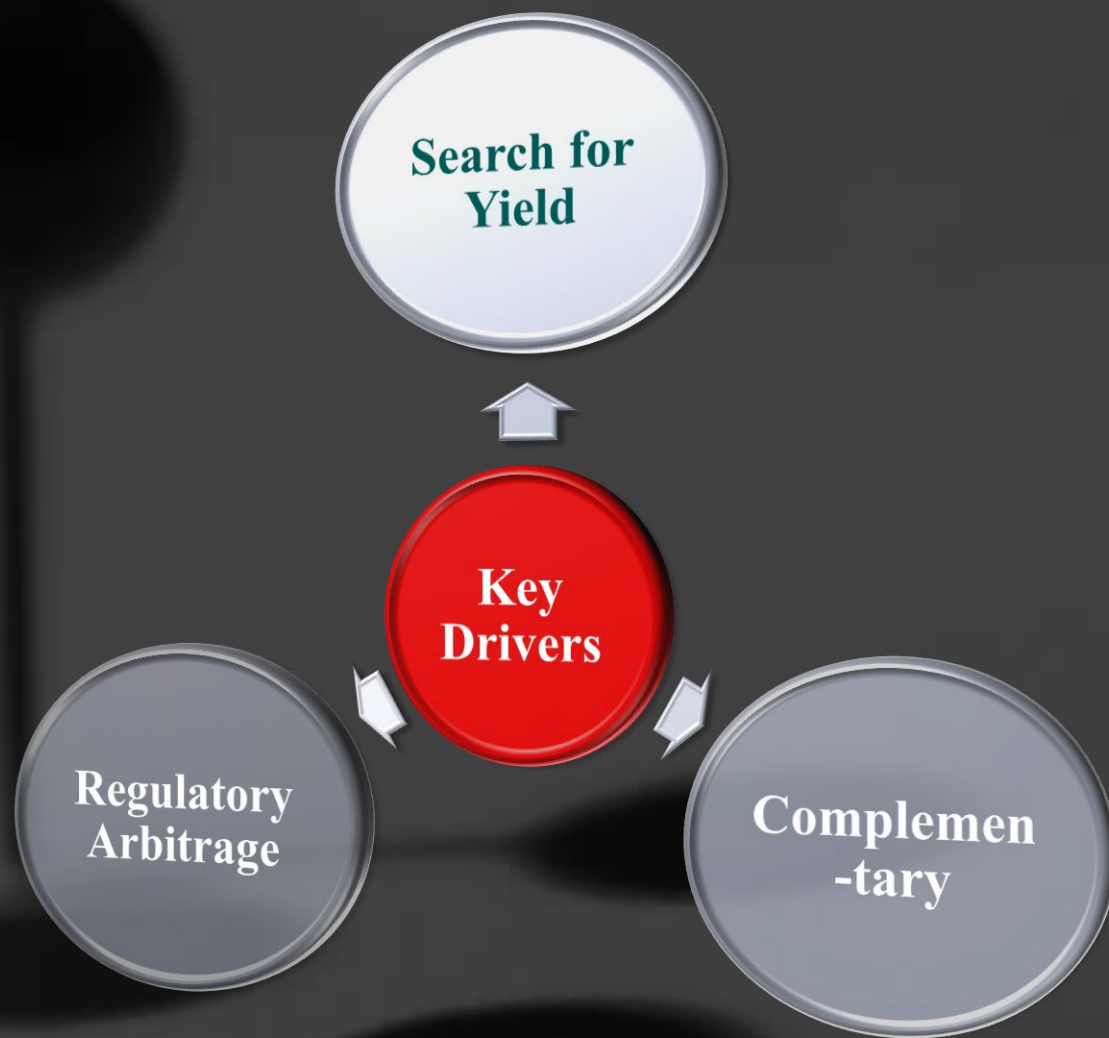


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Key Drivers of SB Growth





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Shadow Banking and Financial Stability





Shadow Banking and Financial Stability

Shadow Banking Risks in the EU

| | | | Asset maturity risk | Asset liquidity risk | Credit risk | Leverage | Inter-connectedness | Size |
|-----------|-----------------------|---------|---------------------|----------------------|-------------|----------|---------------------|------|
| Euro area | Securitization | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | MMFs | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | REITs | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | Bond funds | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | Mixed and other funds | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | Hedge funds | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |

Source: GFSR, Oct 2014, IMF



Shadow Banking and Financial Stability

Shadow Banking Risks in the United States

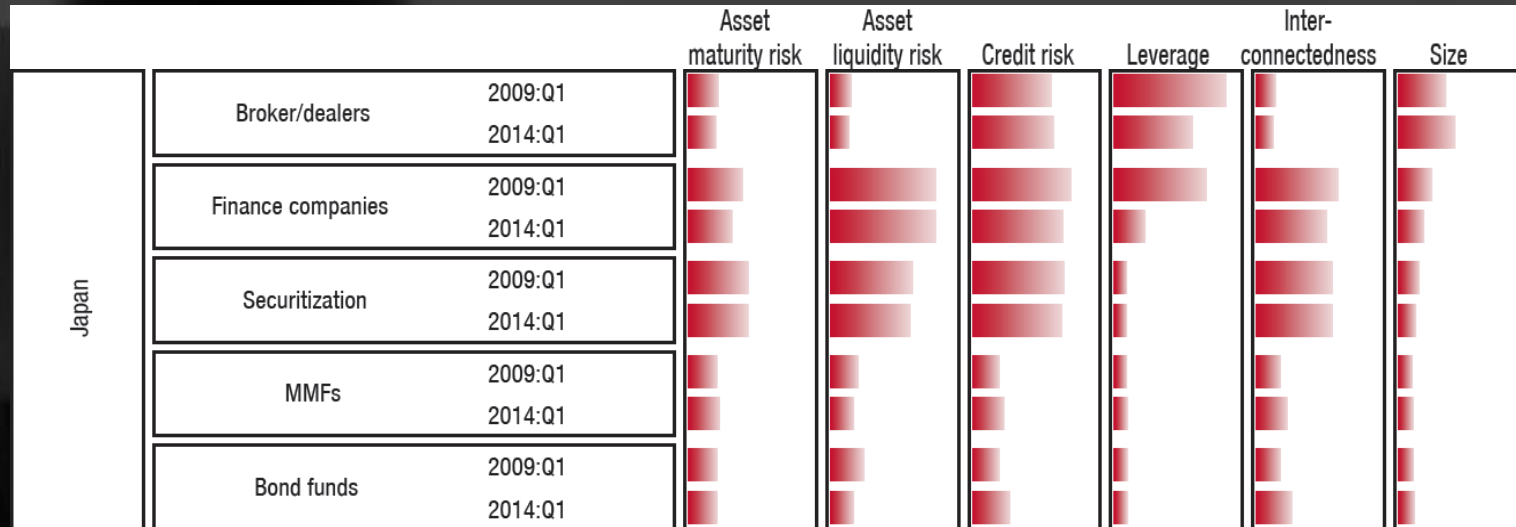
| | | | Asset maturity risk | Asset liquidity risk | Credit risk | Leverage | Inter-connectedness | Size |
|---------------|-------------------|---------|---------------------|----------------------|-------------|----------|---------------------|------|
| United States | Broker/dealers | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | Finance companies | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | Securitization | 2009:Q1 | ■ | ■ | ■ | ... | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ... | ■ | ■ |
| | MMFs | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | REITs | 2009:Q1 | ■ | ■ | ■ | ... | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ... | ■ | ■ |
| | Other funds | 2009:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |
| | | 2014:Q1 | ■ | ■ | ■ | ■ | ■ | ■ |

Source: GFSR, Oct 2014, IMF



Shadow Banking and Financial Stability

Shadow Banking Risks in Japan



Source: GFSR, Oct 2014, IMF



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Regulations & SB's Risks.

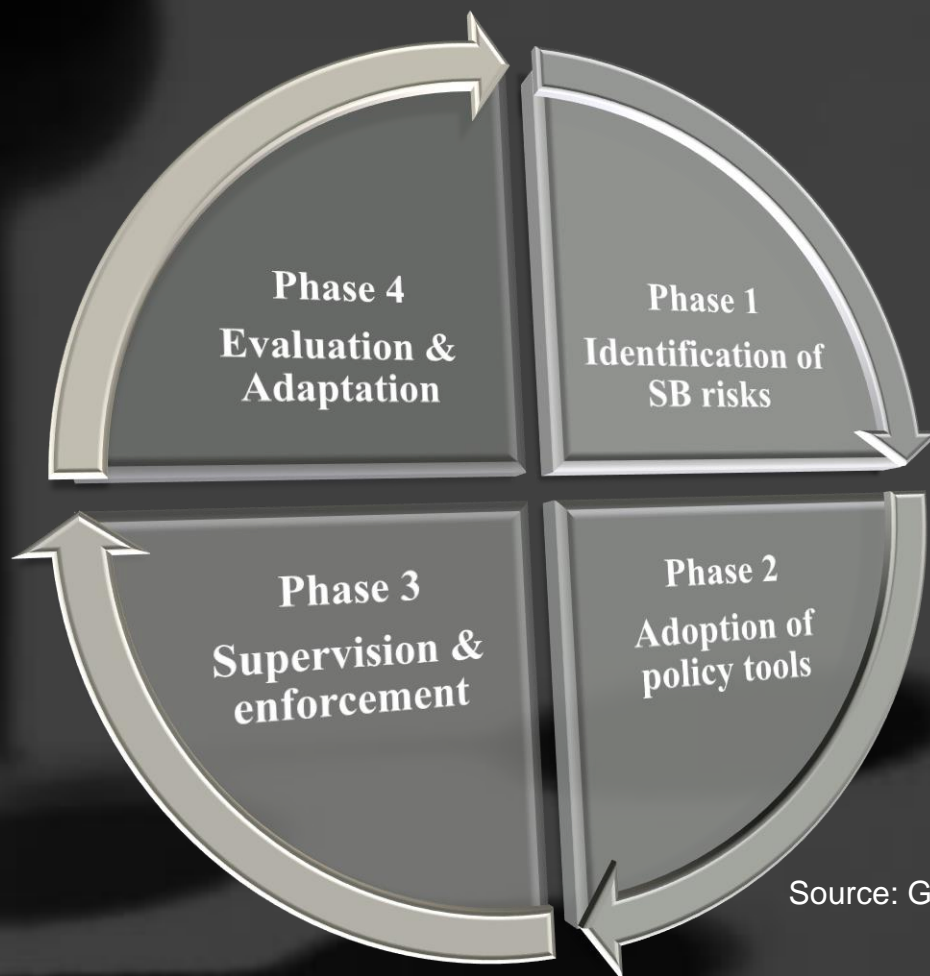
Recently, the IMF has pointed out that Regulators have four toolkits at their disposal to address financial stability risks related to shadow banking:

1. They may impose regulations on shadow banks or address risks indirectly by targeting banks' exposures to shadow banks.
2. They may address the underlying causes of the growth of shadow banking.
3. They, may, under certain conditions, extend the public safety net to (systemically) important shadow banking markets or entities.
4. They may change certain features of bankruptcy laws.



Regulations & SB's Risks.

To handle the potential risks of shadow banking, the IMF suggests adopting the following framework:



Source: GFSR, Oct 2014, IMF



Some Countries' Experiences/ Efforts to handle SB's Risks

In the USA:

- In times of stress, all MMFs may impose liquidity fees.
- Securitized assets to be included in banks' risk-weighted assets.
- Extending the perimeter of prudential regulation and supervision to systemically important non-banks.

In Europe:

- New regulations to be imposed on MMFs including a capital buffer of 3 %, diversification of investment, liquidity, and the eligibility of assets.
- More measures regarding the transparency of banks' investments
- Central repositories have been set up to collect data on derivatives.
- Beginning in 2014, banks are required to report exposures related to SB.
- The definition of "credit institution" is being reviewed with a view to possible extension of the prudential regulatory perimeter.



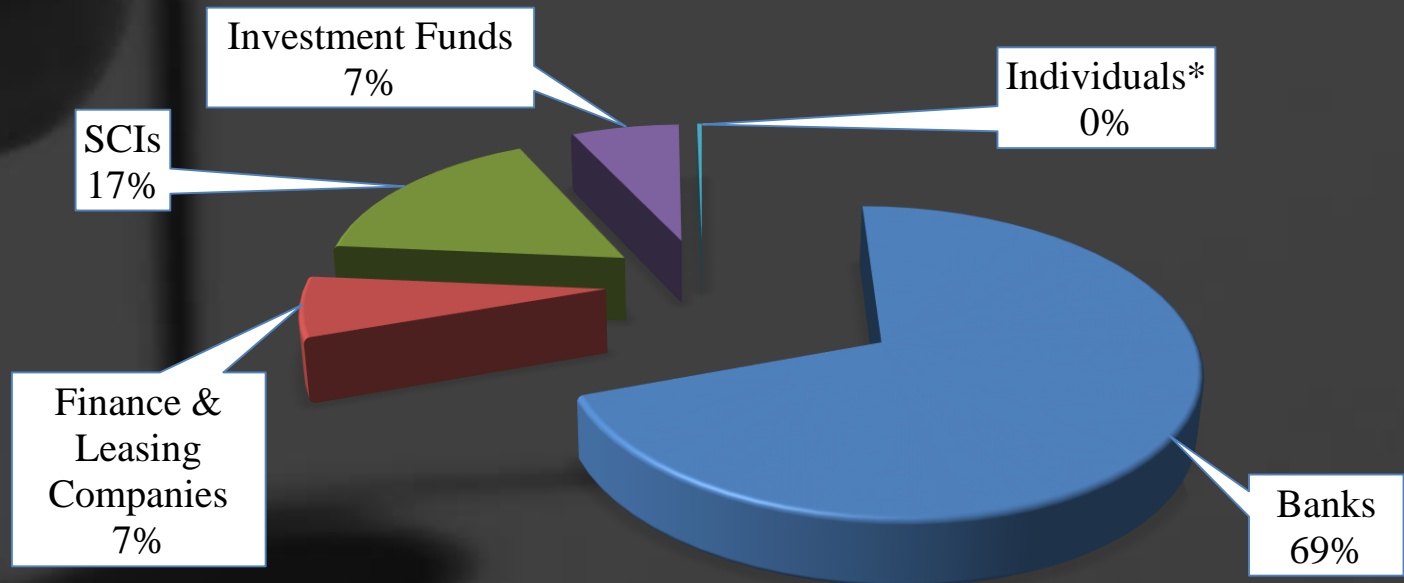
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Saudi Arabia's Case: Highlights

SAUDI ARABIA: SHARE OF CREDIT PROVIDERS
(AS OF JUNE 2014)

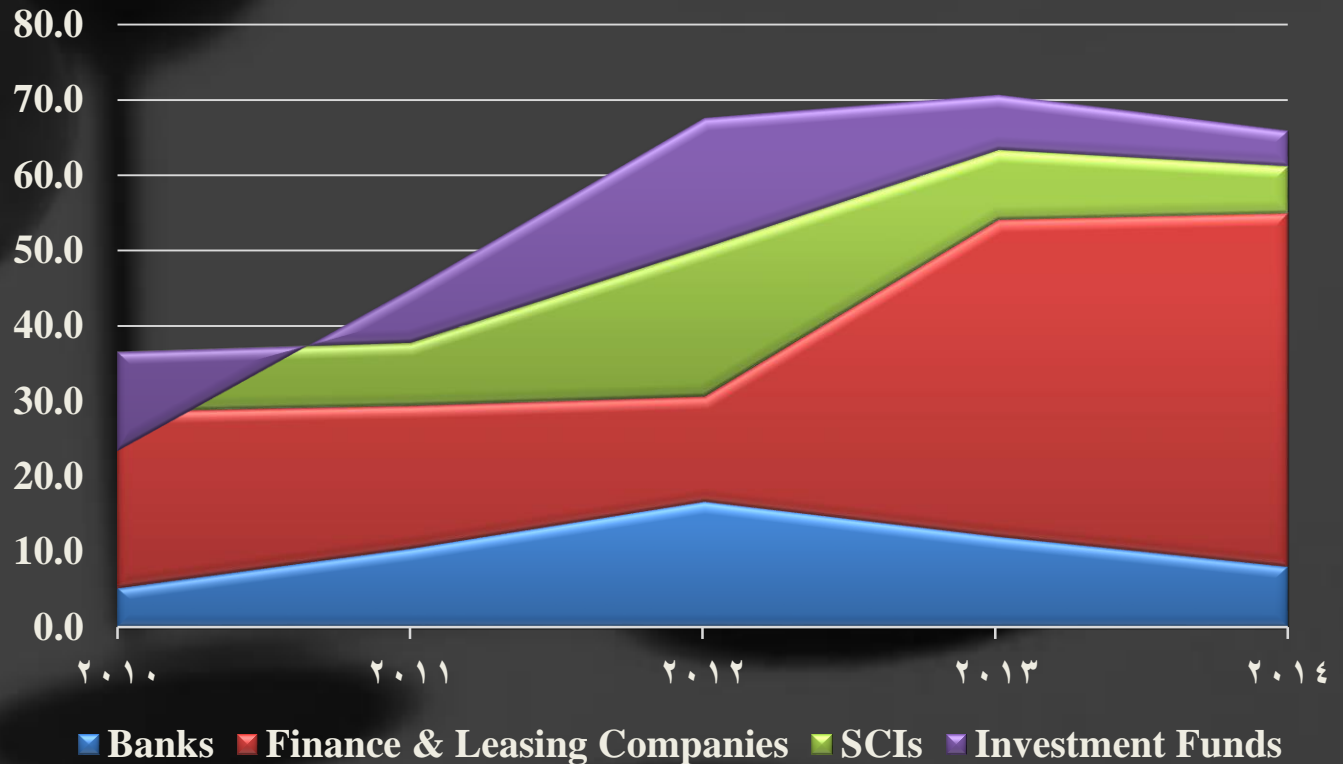


Source: SAMA, CMA



Saudi Arabia's Case: Highlights

Growth of Credit By Providers



Source: SAMA, CMA



Saudi Arabia's Case: Highlights

Finance Companies

Consumer

Commercial

Real Estate

Investment Funds

Shares & Bonds

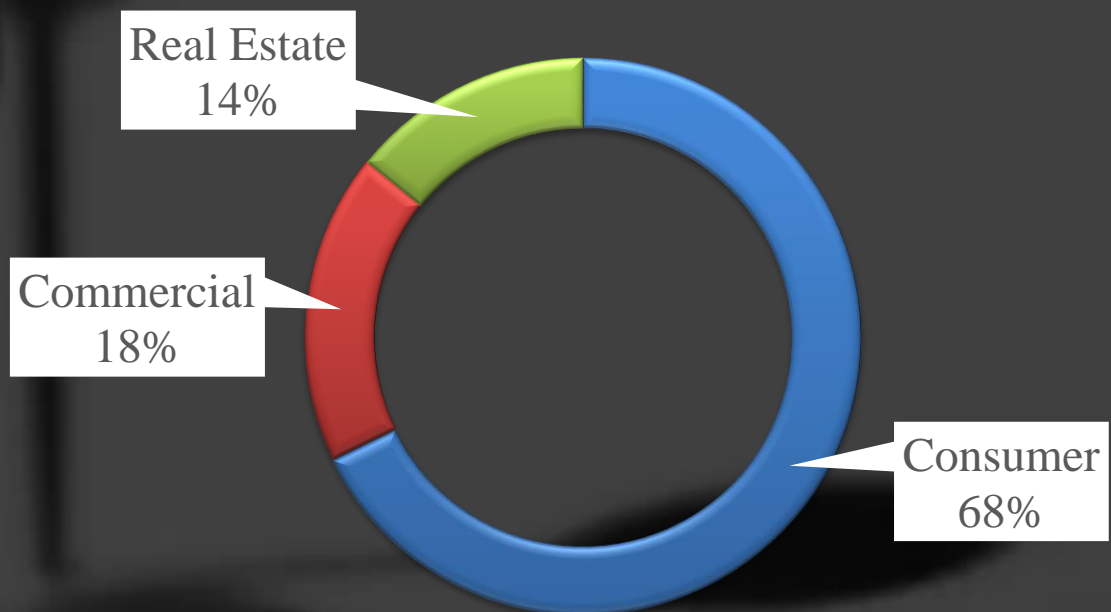
Money Market

Real Estate



Saudi Arabia's Case: Highlights

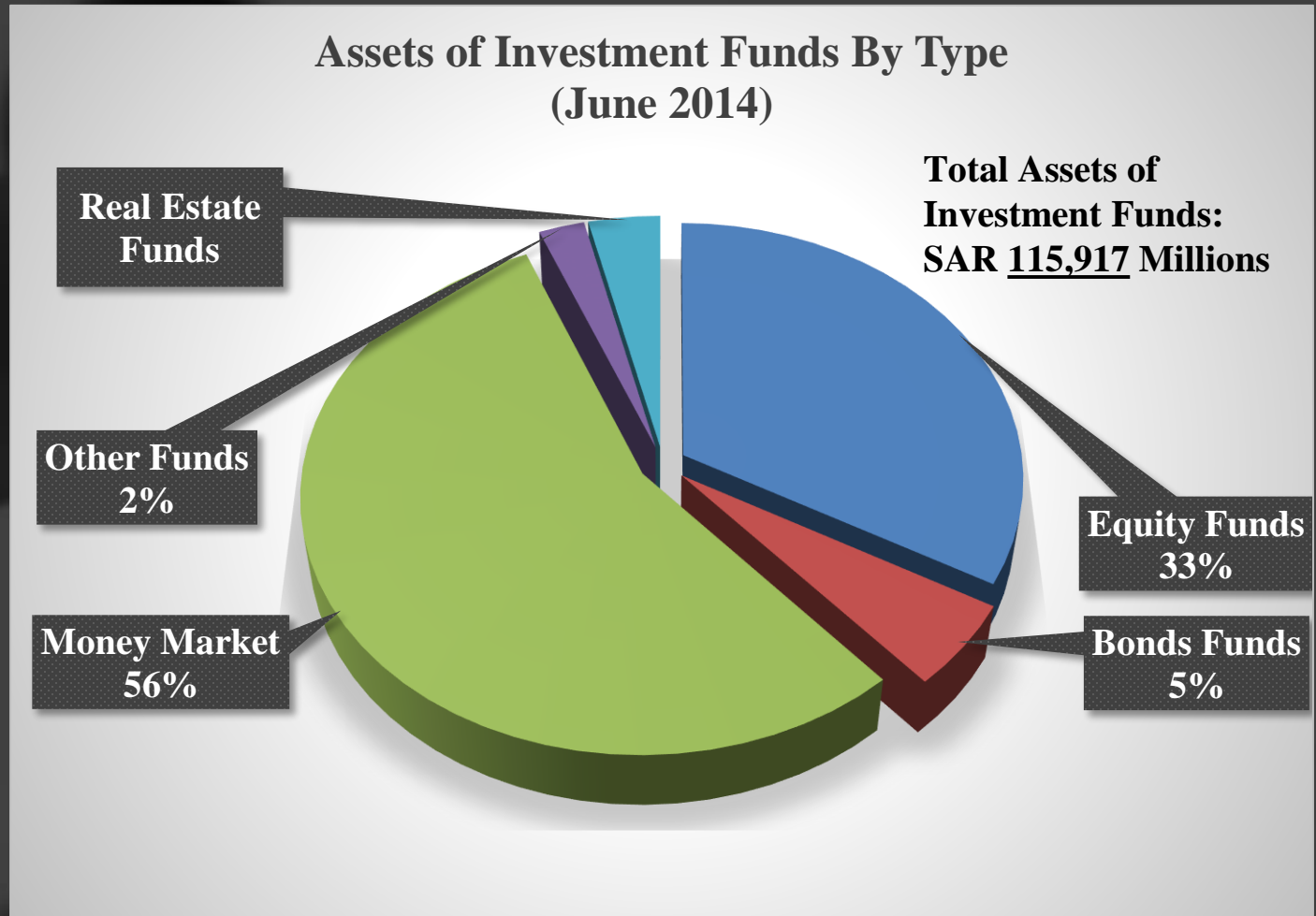
Credit by Finance Companies (June 2014)



Source: SAMA, CMA



Saudi Arabia's Case: Highlights



Source: SAMA, CMA



Conclusions

- Data accuracy is always an issue for shadow banking analysis and measurements.
- Although the IOs have provided definitions for shadow banking, there is a gray area where countries can not identify and differentiate between entities and activities.
- Country's circumstances need to be taken into account when defining the shadow banking. As some countries have different ways of defining intermediary services and based on the systemic risks they impose.
- Constraining the SB might not always be a good solution, as they do have positive impacts on the economy which need to be weighted against possible risks.
- Drivers of shadow banking are not always known and there might be other factors behind those identified in the literature. Take for example, the unavailability of Sharia-compliant products through the regular financial system.



Shadow Banking

Thank You

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