Shadow banking: time to step out into the light

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The avalanche of banking regulation has had as a side effect an increase in the growth of shadow banking. This business has been favoured by laxer regulation and supervision. In fact there is no uniform international supervision or regulation, nor is there a transparent and exhaustive macroprudential framework. As a result, the risks of the financial system could themselves be moving from the banking sector to the shadow banking sector, and it is on this that the spotlight must be trained in order to avoid new bouts of systemic risk. It remains a pending issue of the global regulatory reform initiated at the G20 Summit in Washington in 2008.

What are we to understand by shadow banking? In general terms, shadow banking is considered to mean any financing or creation of credit by intermediaries carried out by financial entities, structures or platforms that are wholly or partly outside the normal banking system. In 2014, this activity accounted for nearly 40% of the total assets of the global financial system, according to the Financial Stability Board. Fragmentation and diversity are the hallmarks of this non-bank universe, which is moreover characterised by a high level of gearing and heavy reliance on short-term funding.

Some examples of shadow banking are: the management of collective investment vehicles, securitisation vehicles, hedge-funds, financial leasing and consumer credit companies. Furthermore, for some time now crowdfunding and peer-to-peer lending have been gaining ground.

Shadow banking can be a very useful tool to complement the banking sector in granting credit, especially in Europe, where approximately two thirds of financing of the economy comes from banks. Non-bank financing can also contribute to improving the competitiveness of the European economy, promoting competition, innovation and economic growth. The proliferation of digital platforms is an example of a source of financing for new ideas and projects. Another advantage of this activity is that in the event of the default of a shadow banking entity, the absorption of losses would be simplified, since it would be the investors that would have to absorb them. It also reduces costs thanks to less intermediation and greater competition.

However, shadow banking reduces market discipline and contributes to exacerbating pro-cyclicality due to its high degree of dependence on short-term funding. Players tend to take advantage of regulatory arbitrage, and players and activities that exploit the advantages of operating in the shadows abound. If shadow banking is not appropriately regulated and supervised, new imbalances may build up, with a negative impact on the financial system and the real economy. One example is what happened with China's biggest peer-to-peer lending platform, where managers used investors' money to enrich themselves.

This highlights two essential points: that the customer must know the risks of this business, and that there is a need to develop regulations that favour an activity in a transparent market environment and with some form of minimum guarantee for investors. Consumers would benefit from gains in efficiency, through prices, on accessing a larger number of more competitive financial services. Financial entities would be able to diversify and reduce their risks thanks to a level playing field between banks and non-banks.

In conclusion, there is a need for a forward-looking approach based on rules that allow shadow banking to be transformed into a transparent and resilient activity. It is important to stress that it is not a matter of directly applying, as such, the existing measures for banks to non-banks. Rather there is a need for a framework that takes account of the particularities of shadow banking while at the same time laying down the same rules of play for the same products or services irrespective of who provides them.

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