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Mapping the Global Shadow Banking System

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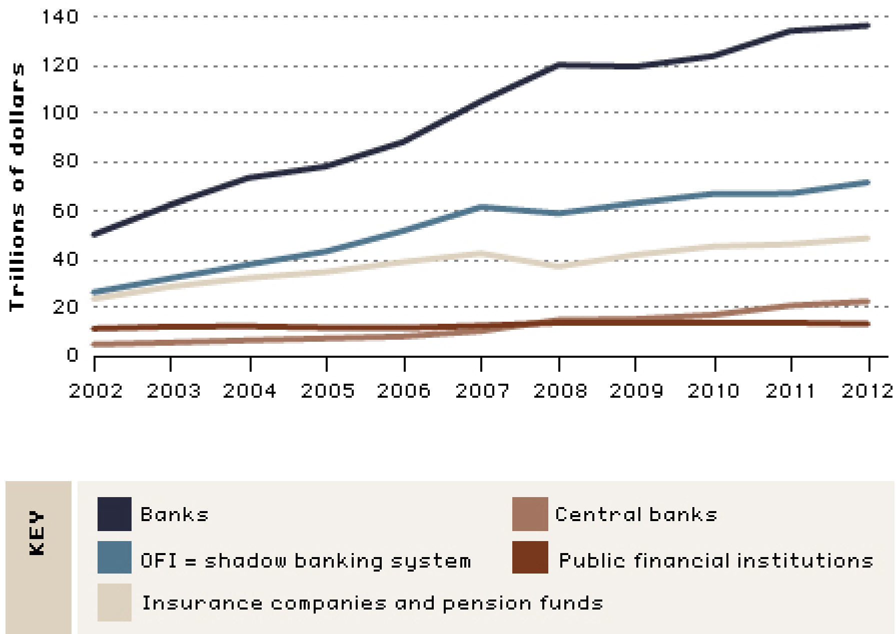
The Financial Stability Board (FSB) has been estimating the size of the shadow banking industry for the past few years. However, the FSB has also been attempting to refine these estimates to filter out certain activities that do not imply direct credit intermediation and to avoid double-counting assets. The progress made by the FSB could change the perspective on potential regulation.

After the leading rich and developing (G-20) nations agreed to the Basel III standards in November 2010, regulatory attention shifted to the shadow banking sector, defined as "financial intermediaries that conduct maturity, credit and liquidity transformation without explicit access to central liquidity of public sector guarantees."[1] In October 2011, the FSB issued its report "Shadow Banking: Strengthening Oversight and Regulation," which is updated annually and included how to better understand, measure and regulate the shadow banking sector.[2]

The results have been presented to the G-20 annually since 2011, with the latest report issued in November 2013.[3] According to the FSB's November 2013 monitoring report, the global shadow banking sector accounted for $71.2 trillion of assets at the end of 2012, up from $26.1 trillion in 2002. The assets account for 24 percent of total financial assets and 52 percent of regulated banking system assets in 20 global jurisdictions, plus the euro area (Figure 1).

FIGURE 1

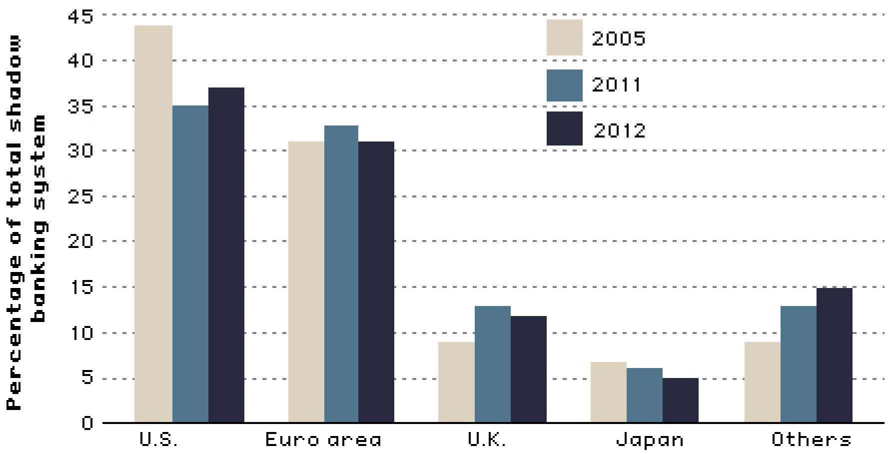
Total Assets of Financial Intermediaries (20 Jurisdictions and Euro Areas)



The shadow banking system is concentrated in economically developed nations, which make up 85 percent of the total estimated global shadow sector. The U.S.'s $26 trillion in assets in 2012 represents the largest share, followed by the euro area, the U.K. and Japan, with $22 trillion, $9 trillion and $4 trillion in assets, respectively (Figure 2). The remaining jurisdictions account for a very small share of the total. However, from their relatively low base, 10 emerging market jurisdictions have been posting the fastest growth rates. In particular, China, Argentina, India and South Africa posted growth rates above 20 percent in 2012.

FIGURE 2

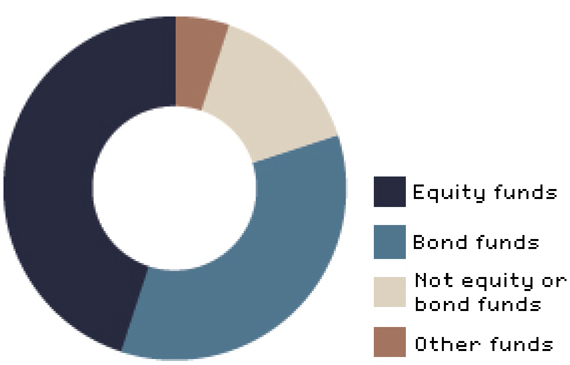
Share of Assets from Nonbank Financial Intermediaries



Shadow banking is composed of an extremely diversified subset of institutions, including broker-dealers, money market mutual funds, structured finance vehicles, financial companies and investment funds, among many others. The largest portion of the sector comprises investment fund companies, totaling $21 trillion in assets, or 35 percent of the total. The November 2013 report contained a breakdown of investment fund companies into equity funds, bond funds and others, with equity funds being by far the largest with $9 trillion invested (Figure 3). Also according to the report, hedge funds comprise only 0.2 percent ($0.1 trillion) of the total shadow banking sector. However, the International Organization of Securities Commissions has estimated that the global hedge fund industry, predominantly domiciled in offshore jurisdictions not included in the FSB report, accounted for $1.9 trillion in net assets under management at the end of 2012. Adding the two estimates brings the hedge fund industry to 3 percent of total shadow banking sector assets.[4]

FIGURE 3

Investment Funds Breakdown



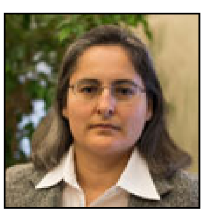
The FSB has attempted to refine estimates of the shadow banking sector by filtering activities that do not imply direct credit intermediation and avoiding double-counting assets already prudentially consolidated into the regulated banking sector. A narrower and more “risk-focused” shadow banking size estimate, presented for the first time in this November 2013 report, is only a preliminary result that does not yet include granular data from all jurisdictions. The FSB report more narrowly defines the shadow banking sector by excluding equity investment funds, which have no direct credit intermediation function.[5] This “risk-focused” estimate more accurately depicts the shadow banking sector and reduces its size estimate without increasing the regulated sector. The opposite was true during the financial crisis when many shadow banking institutions were consolidated into the regulated banking sector, including U.S. broker-dealers and many off-balance-sheet structured-finance vehicles.

Recognizing the diversity of the shadow banking sector can add perspective on how to regulate it. First, it is counterproductive to regulate every existing financial intermediary as a bank, because other institutions will simply step into the market with innovative products to circumvent the regulation. Second, not all shadow banking activities are systemically important or carry contagion risk during a crisis. As seen in recent regulation of over-the-counter derivatives and repo markets, oversight by type of transaction and transparency in previously unregulated markets, where regulated banks and shadow banking institutions transact with each other, is far more important than tailor-made shadow regulation by institution.[6] The G-20 has instead concentrated efforts in markets that were channels of contagion during the crisis and suffered asset fire sales and runs. These include securities financing—such as the repo market—and over-the-counter derivative markets.

Endnotes

1. Pozsar, Zoltan; Adrian, Tobias; Ashcraft, Adam; and Boesky, Hayley. "Shadow Banking." Federal Reserve Bank of New York Staff Reports, July 2010. [back to text]
2. "Shadow Banking: Strengthening Oversight and Regulation." Financial Stability Board, Oct. 27, 2011. [back to text]
3. "Global Shadow Banking Monitoring Report 2013." Financial Stability Board, Nov. 14, 2013. [back to text]
4. "Report on the Second IOSCO Hedge Fund Survey." The Board of the International Organization of Securities Commissions, October 2013. [back to text]
5. This report also nets out other assets already consolidated into the regulated banking sector and excludes self-securitization issues. [back to text]
6. The exception being the tailor-made regulation of money market mutual funds (MMMFs), which should ensure that MMMF deposits do not act like bank deposits without deposit insurance, which are vulnerable to runs by investors. [back to text]

ABOUT THE AUTHOR



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