

Nordic Financial Unions

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## **NFU Response to Commission Green Paper on shadow banking**

### **Summary of main points**

- All financial market companies should be subject to the same duties and controls.
- It is important that the regulatory landscape can be properly and continuously updated and revised in order to ensure that no entities can escape control by staying ahead of the regulators.
- The Commission should investigate how and if current rules for bank liquidity could be extended to apply to all non-regulated bank entities.
- The Commission should thoroughly analyse how insurance and reinsurance undertakings fit into the list of shadow banking entities, since they are already regulated.

### **General remarks**

NFU strongly support the Commission in its strive to analyse and regulate the shadow banking sector. NFU fully agrees that stable, profitable and responsible financial markets are a pre-condition for growth and for the creation of a business environment that allows companies to thrive, innovate and expand their activities.

However, if profitability is the result of a company not being regulated, then its success is built upon unfair competition. There is an increasing area of non-bank credit activity, or shadow banking, which has not been the prime focus of prudential regulation and supervision.

Furthermore, it looks like CRD IV/CRR may encourage financial firms to move activities "off balance" and into the shadow banking system outside the regulated and supervised part of the financial sector. This indicates that measures already taken are not sufficient and do not cover enough of the shadow banking sector. It is therefore highly important that the regulatory landscape can be properly and continuously updated and revised in order to ensure that no entities can escape control by staying ahead of the regulators. NFU agrees with FSB that as long as such activities and entities remain subject to a lower level of regulation and supervision than the rest of the financial sector, reinforced banking regulation could drive a

substantial part of banking activities beyond the boundaries of traditional banking and towards shadow banking.

The global financial crisis has shown that all financial markets, products and market participants need to be regulated in a fair and thorough fashion. NFU believes that the Green Paper marks an important step in the assessment of the shadow banking sector, and future regulations of the same. The "secret" nature of shadow banking makes it extremely difficult to assess risks in the system, and regulation, supervision and transparency is of the utmost importance to ensure that all financial activities are contributing to the economic growth.

## **Specific remarks**

### **a) Do you agree with the proposed definition of shadow banking?**

### **b) Do you agree with the preliminary list of shadow banking entities and activities? Should more entities and/or activities be analysed? If so, which ones?**

NFU agrees with the proposed definition and preliminary list of shadow banking entities and activities, to a certain extent. NFU fully agrees that entities outside the regular banking system, i.e. non-regulated entities that deal with credit intermediation, must be looked into. In general, we believe that all financial players on the market should be subject to the same obligations, rights and controls. There must be fair and equal conditions for all.

This is not the case in the shadow banking system. For example, hedge funds, capital funds and money market funds and some investment banks are able to act as alternative providers of credit, but are not subject to the same regulations and controls as the conventional banking system. It is calculated that the shadow banking system currently accounts for about 25-30% of the global financial market. The unequal conditions are further exacerbated by the fact that the conventional banking sector is increasingly the target of regulations and taxation, while the shadow banking sector gets off scot-free. Thus, credit provision tends to be 'pushed' away from the regulated and over to the unregulated parts of the financial sector. In other words, the shadow banking sector as an alternative credit provider will continue to grow stronger.

NFU therefore fully supports the Commission's strive to create measures that address shadow banking entities and activities, and there is still further progress to be made given the continually evolving nature of shadow banking and our understanding of it. With regard to the innovativeness of the industry, NFU believes that the preliminary list should be considered as just preliminary. It is important that the regulatory landscape can be properly and continuously updated and revised in order to ensure that no entities can escape control by staying ahead of the regulators.

However, NFU urges the Commission to thoroughly analyse how insurance and reinsurance undertakings fit into this picture. Insurance and reinsurance undertakings are already regulated, and the insurance industry has coped rather well with the crisis, and has not suffered the same confidence-loss as other parts of the finance industry. To assume that there are systematic flaws in the insurance industry might be jumping to conclusions.

**c) Do you agree that shadow banking can contribute positively to the financial system? Are there other beneficial aspects from these activities that should be retained and promoted in the future?**

Generally speaking, no. There might be entities and activities in the shadow banking sector that momentarily contribute positively to the regular economy, but if these entities and activities are successful simply because they are unregulated, then their success is built upon unfair competition. As previously stated, NFU believes that all financial market companies should be subject to the same duties and controls. Separate rules for different market actors will contribute to systemically unsound practices.

**d) Do you agree with the description of channels through which shadow banking activities are creating new risks or transferring them to other parts of the financial system?**

Yes. As stated below, it is therefore of the utmost importance that authorities continuously govern hidden credit intermediation chains and map the interconnectedness of the shadow banking system with the rest of the financial sector.

**f) Do you agree with the need for stricter monitoring and regulation of shadow banking entities and activities?**

Yes, there is definitely a need.

**g) Do you agree with the suggestions regarding identification and monitoring of the relevant entities and their activities? Do you think that the EU needs permanent processes for the collection and exchange of information on identification and supervisory practices between all EU supervisors, the Commission, the ECB and other central banks?**

Yes. As pointed out in the FSB paper, monitoring of the shadow banking system must be flexible and adaptable to capture innovations and mutations in the financial system which could lead to emerging risks. Authorities should exchange appropriate information both within and across the relevant jurisdictions on a regular basis to be able to assess the risks posed by the shadow banking system. Assessing the potential for cross-border spill-over and contagion of risks, and obtaining a view on the interconnections at the global level are especially important for cross-border information exchange.

**h) Do you agree with the general principles for the supervision of shadow banking set out above?**

Yes. NFU agrees with the Commission that such supervision must be performed at the appropriate level, i.e. national and/or European (also see reply above). NFU also agrees with FSB that when developing a monitoring framework, authorities should take into account the structure of financial markets and regulatory frameworks within their jurisdiction as well as their international connections. Authorities must be able to understand the hidden credit intermediation chains and map the interconnectedness of the shadow banking system with the rest of the financial sector.



**i) Do you agree with the general principles for regulatory responses set out above?**

Yes. NFU agrees with the Commission and the FSB regarding the potential regulatory responses to address risks in the shadow banking system. For example, NFU strongly supports FSB's idea that consolidation rules should ensure that any shadow banking entities that a bank sponsors are included on the bank's balance sheet for prudential purposes, and that such rules should be applied in an internationally consistent manner.

This would ensure that appropriate consolidated supervision is applied to a bank including its sponsored shadow banking entities and would help to reduce incentives that encourage interconnectedness between the bank and shadow banking entities.

**k) What are your views on the current measures already taken at the EU level to deal with shadow banking issues?**

At this stage, it is hard to tell how successful these measures have been, but time will tell if they have meant any significant changes for the shadow banking sector. At this stage, however, it looks like CRD IV/CRR may encourage financial firms to move activities "off balance" and into the shadow banking system outside the regulated and supervised part of the financial sector. This indicates that measures already taken are not sufficient and do not cover enough of the shadow banking sector. As previously stated, it is highly important that the regulatory landscape can be properly and continuously updated and revised, in order to ensure that no entities can escape control by staying ahead of the regulators.

**n) What modifications to the current EU regulatory framework, if any, would be necessary properly to address the risks and issues outlined above?**

The Commission should, for example, investigate how and if current rules for bank liquidity could be extended to apply to all non-regulated bank entities, including shadow banking entities.

**About NFU**

Nordic Financial Unions (NFU) is the voice of the employees in the Nordic financial sectors. We are an organisation for co-operation between trade unions in the banking, finance and insurance sectors of the Nordic countries. Through our eight affiliated unions in Denmark, Sweden, Norway, Finland and Iceland we represent 160 000 members – a vast majority of the employees in the Nordic financial sectors.

Yours faithfully,

Nordic Financial Unions (NFU)

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