Shadow Banking Activities and Its Supervision in China
-----From an emerging market perspective

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Shall we allow the commercial banks to engage in the shadow banking activities even after knowing there is a variety associated risks?

How can we better manage and supervise the associated risks when we follow the same financial deepening path as those in advanced markets?
What is shadow banking

A system of credit intermediation that involves entities and activities outside the regular banking system, and raises systemic risk concerns and regulatory arbitrage concerns.

(Shadow Banking: Scoping the Issues, FSB, 12 April, 2011)
Reasons for shadow banking

Outcome of financial deepening, intensifying competition.
Selective result of consumers and investors.
Side effect of strengthening supervision on regular banking.
Our Stance: Shadow banking must be regulated

- **Source of Systemic Risk**
  - Maturity/liquidity transformation.
  - Leverage.
  - Flawed credit risk transfer.
Our Stance: Shadow banking must be regulated

- Creating significant money flow beyond the regular banking system that weakens monetary policy and macro-prudential supervision.
- Creating regulatory arbitrage that undermines micro-prudential supervision and leads to a build-up of additional leverage and risks.
Shadow banking entities in China

Entities

Non-bank financial institutions
- Securities Company, Trust, Finance Company

Non-financial institutions
- PE, VC, Small lending company, Pawn shop

Others
- Informal lending channels and activities among public
Shadow banking activities in China

As of 2010, USD, Billion

- PE: 19.61
- VC: 5.67
- Small lending Companies: 24.52
- Pawn: 12.79
- Trusts' Credit-related wealth management products: 250.76
- Securitisation: 2.75
Estimated size of shadow banking

Graph showing total financing, banking RMB loan, and total financing/GDP from 2002 to 2010.
Breakdown of total financing

As of 2010

- Corporate bond
- Others
- Banking RMB Loan
- Bank Acceptance
- Trust Loan
- Entrusted Loan
- Non-financial institution equity
- Banking FX Loan
Our concerns

• Systemic Risk Concern:

  - Implicit or explicit guarantee by banks to shadow banking activities
  - Overseas complex products sold to domestic investors
  - International money striking domestic property and commodity markets
  - Short-term funding supporting long-term investment by LGFP

LGFP: Local government financing platform
Our concerns

• Regulatory Arbitrage Concern:

➢ Banks cooperate with trust companies to sell credit-related wealth management products to evade regulatory capital requirement.
Our efforts

• Our regulatory philosophy:
  ➢ Chinese wall between commercial banks and capital markets
    ✓ Disallow banks’ guarantee for corporate bond issuance.
    ✓ Limit commercial banks’ reliance on capital market for liabilities-side funding.
  ➢ Equal attentions paid to on-balance-sheet items and off-balance-sheet items, same risk weighting applied to activities with identical risks
Our efforts

- Oversight Conference at State Council, chaired by vice premier.

- Coordination regime set up among domestic regulators and the central bank.

  - PBOC: People’s Bank of China
  - CBRC: China Banking Regulatory Commission
  - CSRC: China Securities Regulatory Commission
  - CIRC: China Insurance Regulatory Commission
Our efforts

• Strengthening supervision on interactions between banks and trust companies

  ➢ Focus on trust companies selling credit-related wealth management products
  ➢ Rules made to urge commercial banks move corresponding off-balance-sheet exposures into their balance sheets, and set aside provisions at a provision coverage ratio of 150%
Our efforts

- New rule published on credit assets transfer

  - Assets should be transferred truly, cleanly and wholly.
  - Relevant assets and risks should be booked correctly.
Our efforts

• Securitization

- Continues to move ahead with securitization.
- Risks to be controlled properly.
- Underlying assets should be good.
- Risk management responsibility should be retained.
Our efforts

• Approaches to other players (VC, PE, etc.)

  ➢ Enhance transparency.
  ➢ Improve ethics and expertise of practitioners.
  ➢ Transactions between banks and these players are monitored carefully.
Challenges: Identifying risks in banks and their shadows

- Segregated financial sectors
- Data collection problems
- Entities not closely watched
- Different watchdogs
  - The Flow of Funds data lack granularity in terms of financial sectors
  - Lack of quality information on entities not regulated
  - Data on regulated non-bank entities lack consistency and sufficiently long time series.

- Pawn shop, Small lending company, PE, VC
### Industry Developments vs. Dilemmas

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<td>Universal banking vs. Specialization</td>
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<td><strong>SBU Centers:</strong>&lt;br&gt;➢ 15 licensed in Shanghai, ranging from treasury, credit card, SMEs&lt;br&gt;➢ 44 non-licensed in Shanghai</td>
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<td><strong>Entities:</strong>&lt;br&gt;➢ Financial Holding Companies&lt;br&gt;➢ Bank holding companies investing in fund managers, insurance companies, financial lease companies, trusts.</td>
<td>Single Watchdog vs. segregated Watchdogs</td>
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Conclusion

In order to make sure that when a devil climbs one post, a priest should climb ten.

- Supervision should be more balanced, comprehensive and thorough.
- Regulation needs coordination, communication and all-around consultation among regulators and the industry.
Together. We can make a difference in policing the perimeter

THANKS

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