

# The Shadow Banking System of China and International Regulatory Cooperation





# The Shadow Banking System of China and International Regulatory Cooperation

Zheng Liansheng



Copyright © 2015 by the Centre for International Governance Innovation

The opinions expressed in this publication are those of the author and do not necessarily reflect the views of the Centre for International Governance Innovation or its Board of Directors.



This work is licensed under a Creative Commons Attribution — Non-commercial — No Derivatives License. To view this license, visit ([www.creativecommons.org/licenses/by-nc-nd/3.0/](http://www.creativecommons.org/licenses/by-nc-nd/3.0/)). For re-use or distribution, please include this copyright notice.



67 Erb Street West  
Waterloo, Ontario N2L 6C2  
Canada  
tel +1 519 885 2444 fax +1 519 885 5450  
[www.cigionline.org](http://www.cigionline.org)

# Table of Contents

About the New Thinking and the New G20 Project	vi
About the Author	vi
Acronyms	1
Executive Summary	1
Introduction	1
The Shadow Banking System and Its Potential Risks	2
International Regulatory Coordination in Shadow Banking	3
China's Views of International Regulatory Coordination on Shadow Banking	4
The Shadow Banking System of China and its Regulation	6
An Analogous Logic: China's Shadow Banking Regulation System	8
Conclusions and Policy Suggestions	10
Works Cited	12
Acknowledgements	12
About CIGI	16
CIGI Masthead	16

## About the New Thinking and the New G20 Project

The project aims to promote policy and institutional innovation in global economic governance in two key areas: governance of international monetary and financial relations and international collaboration in financial regulation. Sponsored by CIGI and the Institute for New Economic Thinking, the project taps new research and next-generation scholars in the emerging economies, linking them to established networks of researchers in the industrialized world. The objective over the longer run is to create a more permanent and self-sustaining research network that will provide a continuing stream of new ideas, sustain international collaboration and integrate researchers from the emerging economies into global policy discussions.

Miles Kahler and Barry Eichengreen (principals in the original project) recruited C. Randall Henning (new principal, American University) and Andrew Walter (University of Melbourne) to lead two research teams devoted to macroeconomic and financial cooperation and to international financial regulation. Gathering authors from eight countries, the project consists of 11 CIGI papers that add to existing knowledge and offer original recommendations for international policy cooperation and institutional innovation. CIGI will also publish the final papers as an edited volume that addresses the global agenda in these issue-areas.

## About the Author



Zheng Liansheng is a senior research fellow and deputy director of the Research Center for Financial Law and Regulation at the Institute of Finance and Banking, Chinese Academy of Social Sciences (CASS). Liansheng served as chief investment strategist of Guangfa Funds Management from 2012 to 2013 and senior economist of China Securities Company from 2009 to 2012 before joining CASS in July 2013. He was a researcher at the Asia-Pacific Finance and Development Center, in China's Ministry of Finance 2007 to 2009. He started his career as an engineer at Shanghai Aircraft Institute in 2002. He received his Ph.D. in economics from CASS in 2011.

## Acronyms

BCBS	Basel Committee on Banking Supervision
CBRC	China Banking Regulatory Commission
CNKI	China National Knowledge Infrastructure
ECB	European Central Bank
GFC	global financial crisis
PBoC	People's Bank of China
FSB	Financial Stability Board
G20	Group of Twenty
IMF	International Monetary Fund
MMF	money market fund
WS3	Workstream Three (FSB's Standing Committee on Supervisory and Regulatory Cooperation)

## Executive Summary

The “shadow banking” system, as a credit intermediary outside of regulation and the regular banking system, has been regarded as one of the critical sources of the global financial crisis (GFC). International coordination of regulation on shadow banking has substantially improved since 2009, but bilateral and multilateral cooperation among advanced economies and emerging markets has made little progress. This is due to a combination of factors: the changing interests and attitudes of the developed economies; the passive approach of the developing world; great differences in financial market structures; the lack of enforcement of international standards; overreliance on political pressure through the Group of Twenty (G20); and the professional, technical and linguistic weaknesses of emerging countries. China has witnessed a rapid growth of shadow banking in recent years and its attitude to international coordination in regulation of the shadow banking system has changed from a following strategy to a constructive, inclusive and pragmatic approach. However, its main goal is to develop a comprehensive domestic regulatory framework for shadow banking. Enhancing international collaboration presents a number of challenges. To overcome these challenges, necessary institutional reforms include a system of information sharing, the establishment of a third-party consultancy mechanism, further improvements to the regulatory framework and investments in building the regulatory capacity of emerging countries.

## Introduction

The shadow banking system was defined in 2007 by Paul McCulley, the managing director of Pacific Investment Management Company, but it began to receive significant attention in the immediate aftermath of the GFC. Since the beginning of the financial crisis in 2008, the regulatory agencies of different countries, international organizations and think tanks have all carried out in-depth research into shadow banking and have released a series of results. Regulatory reforms have also addressed shadow banking, the most important of which is the US Dodd-Frank Act of 2010, which aims to restrain the expansion and risk taking of shadow banking in the United States. The United Kingdom and the European Union have also adopted reforms and built up a supervisory system to track the risks of the shadow banking system.

At the international level, the G20, the Financial Stability Board (FSB), the International Monetary Fund (IMF) and the Basel Committee on Banking Supervision (BCBS) have all turned their attention to coordination of regulation of shadow banking since 2008. Yet there is a lingering concern that the stricter regulation of traditional commercial banking will push still more financial activity into the comparatively lightly regulated shadow banking. This logic is reasonable, but the shadow banking system has experienced relatively low growth in the past two to three years. Some leading financial institutions, such as Goldman Sachs, J. P. Morgan and Barclays, have adjusted their shadow banking business structure, selling or trying to sell their proprietary trading units in the first half of 2014.

Within emerging countries, the shadow banking system has witnessed rapid growth since 2008. Emerging countries introduced a series of stimulus policies after the GFC, which amplified the gap between the demand and supply of capital. This expanding gap is the fundamental reason for the boom of shadow banking in emerging markets such as Brazil, China and India. But shadow banking remains a new ingredient in their financial systems. Shadow banking in emerging markets is also quite different from that of advanced countries. The risks of shadow banking and its impacts for financial stability are more difficult to track in emerging countries. It is also a highly controversial topic in emerging countries, so that despite the attention it has received there is as yet no consensus on what should be done.

G20 summits have provided the main impetus to improve international coordination in the regulation of the shadow banking system. Since the first leaders' summit in November 2008, the G20 and its related entities have discussed this topic in depth several times, from the working group level to the summit level. The FSB published a regulatory framework on August 29, 2013, which was approved in principle by G20 leaders at St. Petersburg. The FSB has also established a road map to transform shadow banking into resilient market-based financing. Leaders of the G20 endorsed these proposals in



Brisbane and agreed to address the risk channels between banks and non-banks, which are strongly related to shadow banking (G20 Leaders' Communiqué 2014).

Despite these achievements, international coordination between advanced economies and emerging markets has made little progress. Mark Carney, chairman of the FSB, has identified the shadow banking system as the greatest danger to the global economy, particularly the shadow banking system in the large developing economies (*The Economist* 2014; Evans-Pritchard 2014). The general commitment of the G20 to tight coordination is weakened by the low participation of emerging markets in this process.

This paper addresses the problem from the perspective of emerging markets, focusing on the case of China. The remainder is structured as follows. The second section describes the shadow banking system and its potential risks. The third section considers the progress of international cooperation and coordination in the regulation of shadow banking from the perspective of emerging markets. The fourth section considers the case of China and the relation between China's regulation and international coordination. The final section concludes and offers policy suggestions.

## The Shadow Banking System and Its Potential Risks

### Definitions

In 2007, Paul McCulley first put forward the concept of shadow banking to refer to those financial institutions outside of traditional financial regulatory systems. In 2008, Timothy Geithner, then president of the Federal Reserve Bank of New York, called it “the parallel banking system,” as it was considered to exist in parallel to the commercial banking system (Geithner 2008). In terms of scope, shadow banking refers to non-banking financial entities, such as investment banks, private equity funds, money market mutual funds, mortgage intermediaries, hedge funds, bond insurance companies and structured investment vehicles.

The European Central Bank (ECB) defined shadow banking as the credit intermediary outside of the regulated banking system and emphasized its primary characteristic of circumventing such regulation (ECB 2012). In this view, the emergence of shadow banking is largely attributed to the popular “originate-to-distribute” model, which enables a bank to transfer a regulated asset on its balance sheet to an unregulated off-balance-sheet entity, usually some form of securitization vehicle, so as to evade relevant regulation.

Despite the lack of agreement, the most authoritative point of view comes from the FSB, which characterizes the shadow banking system as serving the role of credit intermediary

outside of regulation and the regular banking system. The FSB (2011) defines shadow banking as “credit intermediation involving entities and activities (fully or partially) outside the regular banking system” or, more succinctly, “non-banking credit intermediation” (ibid., 1)

More importantly, the FSB attributed four intrinsic features to the shadow banking system: maturity transformation, liquidity transformation, credit risk transfer and leverage. The FSB's definition of shadow banking has gained near-worldwide assent, but as the FSB follows only 25 economies and the euro area as a whole (about 80 percent of global GDP and 90 percent of global financial system assets), its definition may not apply to all economies and policy frameworks, even among these 25 economies (Sinha 2013).

### The Global Shadow Banking System

The FSB definition uses subjection to regulation as the criterion to define shadow banking, but its statistics are gathered from the sectors of non-banking financial intermediation based on the “macro-mapping” approach, which uses national flow of funds and sector balance sheet data. According to the FSB's data collection system, the shadow banking system is approximately equal to all financial intermediaries other than the formal banking sector. These include collective investment vehicles, money market funds (MMFs), finance companies, structured finance vehicles, hedge funds, other investment funds (equity funds and fixed income/bond funds), broker dealers and others.

According to the FSB definition, the total size of the global shadow banking system was about US\$75.2 trillion by the end of 2013. The FSB has published its fourth annual monitoring report for the global shadow banking system using data to the end of 2013 (FSB 2014). The global shadow banking system witnessed 6.8 percent growth, or US\$4.8 trillion, in 2013. Developed economies had the largest non-bank financial sector. The United States and the euro zone both had total assets of US\$25 trillion at the end of 2013. Shadow banking in the United Kingdom and Japan had assets of US\$9.3 trillion and US\$4.4 trillion, respectively.

The growth of the shadow banking system in emerging economies is faster than that of the developed countries. China ranked number five in the global shadow banking system with assets of US\$3 trillion in 2013 (compared to only US\$40 million in 2010), or four percent of the global shadow banking system (from only one percent in 2007). The shadow banking sector of Argentina grew more than 50 percent in 2013, followed by China, Turkey and South Africa with expansion rates above 20 percent. The seven countries with the highest development rates were all emerging markets (FSB 2014).

### The Potential Risks of the Shadow Banking System

In order to establish a comprehensive regulatory framework, the FSB suggests regulatory authorities pay attention to the four aspects of economic function: maturity transformation,



liquidity transformation, credit risk transfer and leverage (FSB 2011). These four intermediation business models would lead to essential risks, such as maturity mismatch, liquidity risks and systemic crisis.

At the same time, the FSB (2013) has built up an assessment system based on the economic functions of shadow banking. It points to five potential risks of the shadow banking system: spillover effects to the banking sector; susceptibility of MMFs to runs; leverage and maturity mismatches buildup by securitization; pro-cyclicality; and systemic risks.

The interconnectedness problem between the regular banking sector and the shadow banking system is at the top of the five specific risks identified by the FSB. The BCBS has developed a series of policy proposals to deal with the spillover problem to ensure all banks' interactions with the shadow banking system are appropriately managed from a prudential perspective. The BCBS also limits the regular banks' external exposure to individual shadow banking entities to control the potential challenges caused by imperfect credit risk transfer. The G20 leaders' summit in Brisbane also issued requirements for regulators to control risk contagion between mainstream banking and shadow banking.

## International Regulatory Coordination in Shadow Banking

### The G20 and International Regulatory Cooperation in Shadow Banking

As the shadow banking system has been considered one of the major root causes of the GFC, strengthening the supervision and regulation of shadow banking, and enhancing international cooperation and coordination, have been among the important tasks for the international community since the G20 Summit on Financial Markets and the World Economy held November 14-15, 2008, in Washington, DC. Although at that meeting G20 leaders did not explicitly mention the shadow banking system, the committed common principles for reform issued at that meeting are closely connected with the shadow banking system: strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets and reinforcing international cooperation (G20 Leaders' Declaration 2008).

Since 2008, the G20 has provided the main impetus for the regulation of, and international cooperation on, shadow banking. The London, Pittsburgh and Toronto summits all emphasized this topic and committed to implement further actions. The G20 leaders formally raised the shadow banking system for the first time at the Seoul summit in November 2010, and instructed the FSB to provide policy recommendations to improve its regulation. The G20 appointed the FSB as the global regulatory authority for the oversight and supervision of shadow banking

in 2011; since then, the FSB has driven major developments in regulation and international coordination.

### The FSB and International Coordination

The FSB has built up a two-pronged oversight and regulatory framework for the global shadow banking system. The first part is a system-wide monitoring framework that strengthens individual regulatory authorities' ability to oversee dynamic changes of the shadow banking system and to identify the potential systemic risks. The second is a coordinated policy framework identifying five areas where oversight and regulation need to be enhanced to reduce systemic risks.

The FSB maintains the monitoring framework by collecting data through macro- and microchannels. The macrochannel has four sets of data and the micromechanism has three. The FSB recommends that all countries should monitor the shadow banking system based on the flow of funds, analyze the data combining the information of financial intermediaries and all other kinds of non-financial institutions, and oversee the internal relationships between the regular banking sector and non-bank financial intermediaries.

As far as the regulation system is concerned, the FSB has established a high-level policy framework. The framework, published on August 29, 2013, and approved at the St. Petersburg G20 Summit in September 2013, has three pillars (G20 Leaders' Declaration 2013). The first pillar is the framework of five economic functions (or activities) to identify whether non-bank financial entities are involved in non-bank credit intermediation and thus determine the sources of shadow banking risks in non-bank financial entities. The second pillar is a framework of five overarching principles and a policy tool kit. The FSB recommends that individual authorities apply the principles for all economic functions done by non-bank financial entities. The tool kit, including five associated kinds of policy tools, aims to mitigate financial stability risks for financial authorities. The third pillar is the information-sharing system among individual regulatory authorities through the FSB process.

### The Development of International Regulatory Coordination on Shadow Banking

The FSB framework emerged after more than a year of tough discussion and argument, dominated by the interests of the major developed countries. This demonstrates the difficulty of moving from an academic discussion of shadow banking to practical recommendations. This is particularly true for emerging countries, for whom the relevance of the FSB framework is less significant. For instance, a great deal of non-bank credit intermediation in China is not leveraged for higher profits. It is difficult to use FSB standards to control the leverage rate of non-bank credit activities. Data collection is also more challenging in emerging markets.

Emerging country officials raised many different points at the working group level, the minister level and even at the summit level (Xiao 2012). They argued that international regulation and coordination should be founded on the function of the non-bank credit activities rather than on the FSB definition, and that it should take into account differences between countries rather than adopting a single set of integrated standards.

But crucial issues remain unaddressed. First, mechanisms to mitigate the spillover effect between the regular banking system and the shadow banking system, and to reduce spillover from the developed financial markets to the emerging markets, have not been established. Second, mechanisms to coordinate the views of emerging markets on shadow banking are lacking. Third, an integrated system of global regulation and information exchange remains a distant goal. How to solve these issues is strongly related to the cooperation of advanced countries and emerging markets.

The first constraint lies in the advanced countries. Although the shadow banking system is seen as a root cause of the GFC, some advanced countries — notably the United States and United Kingdom — believe that the financial innovation driven by shadow banking will be beneficial to financial competition and resource allocation under a sound regulatory system. An excessively strict or broad regulatory framework might also lead to a more secretive shadow banking system. Therefore, American and British officials prefer a global system based on common principles rather than on more precise international standards.

The second issue is that some emerging countries believe the international regulatory framework is currently mainly relevant to the advanced countries and that a wait-and-see approach is optimal for countries in which shadow banking is evolving rapidly. Other emerging economies, such as China and South Korea, regard the US financial system as a blueprint and design financial reforms to build a US-like financial system. Generally, the diversity of concerns among emerging countries makes it difficult to achieve unity. Most emerging countries are not able to take other partners' concerns seriously, making it difficult to move beyond common principles. That means emerging countries need to improve their own capacity to communicate and coordinate with their partners.

The third issue has to do with the regulatory framework itself, which has no legal significance. Implementation depends on the commitments of the G20 leaders, with uncertain credibility over the long term. Some emerging markets might believe that in the absence of law enforcement it is not necessary to become deeply involved in the international cooperation efforts in this field.

Finally, process or technical problems are significant. For one, although the FSB has tried to improve the representation of emerging and developing economies, their representation at

management and technical levels remains low.<sup>1</sup> There is also a trade-off between representation and efficiency. In order to improve the coordination process and preserve the effectiveness of its decision-making process, the FSB might sometimes ignore temporarily some emerging countries' concerns and requirements. Another problem is that the technical skills of emerging countries, including China, still have great room for improvement. For example, high-leverage operations, securitization and derivatives are very new business models for Chinese officials. Meanwhile, language can be yet another challenge for them.

## China's Views of International Regulatory Coordination on Shadow Banking

### Changing Attitudes

Initially, Chinese authorities saw the shadow banking system as the fundamental source of the GFC, of which China was a victim. The spillover effect from advanced markets to the emerging markets was significant and had a strong negative impact on China. Therefore, China strongly supported the G20 and related international organizations in their efforts to enhance the regulation of shadow banking. However, the main impact of the crisis came through trade linkages: because of China's capital controls, its direct exposure to the shadow banking system of advanced markets was quite limited in the GFC. As a result, China's authorities thought that the relevance of the shadow banking system in the Western world was very low. So China held a neutral attitude to the international cooperation and coordination in regulation on the shadow banking system and acted as a follower, like most emerging economies before 2010.

After 2010, the boom in China's own shadow banking system led to a shift in China's basic attitude to a constructive and positive position. The decision in 2010 by the People's Bank of China (PBoC) to focus on aggregate financing to the real economy rather than broad money to measure liquidity supply highlighted the importance of non-bank credit intermediation. The ratio of non-bank credit expansion to aggregate financing has increased significantly to nearly 50 percent in 2013 (from about 4.5 percent in 2002), or ¥8.4 trillion of non-bank credit to ¥17.3 trillion of aggregate financing. The PBoC and the China Banking Regulatory Commission (CBRC)<sup>2</sup> concluded that it

1 For example, Ashley Ian Alder, chief executive officer of the Securities and Futures Commission of Hong Kong, and Muhammad bin Ibrahim, deputy governor of Bank Negara Malaysia, co-chaired the working group on shadow banking of the FSB. Alder is not Chinese, though he has been working in Hong Kong for over 20 years and might know China's financial system well.

2 CBRC has regulatory authority for bank and non-bank institutions (excluding securities and insurance).

is a critical task to regulate and supervise the shadow banking business (in non-bank credit intermediation) and its potential risks.

Although the non-bank credit intermediation of China is very different from that envisaged by the FSB, China's regulatory authorities are eager to know how the FSB and other countries deal with the risks posed by the shadow banking system. Through the working group mechanism of the FSB's Standing Committee on Supervisory and Regulatory Cooperation,<sup>3</sup> China has been deeply involved in developing a global regulatory framework, policy tool kits and regulation standards for the shadow banking system.

The basic objectives of authorities might be thought of as follows. First, the regulators regard international cooperation as an effective and efficient approach to understanding shadow banking, including its scope, role, risks and impacts. Second, they believe the policy framework and the tool kits set by the FSB will be an important reference for China to establish a regulatory system for non-bank credit intermediation and the shadow banking system. Third, the banking sector is deeply involved in shadow banking via inter-bank business. China's shadow banking system has thus become more complicated than those of Western economies. Regulatory arbitrage is very serious between the commercial banking sector (whose assets were about 260 percent of China's GDP in 2013) and the shadow banking system (CBRC 2014a; National Bureau of Statistics of China 2014).

### China's Attitude to International Regulatory Standards

The FSB's policy tool kits for regulating shadow banking cover five aspects of shadow banking entities and/or activities: collective investment vehicles with run risk, loan provision depending on short-term funding or on secured funding of client assets, facilitation of credit creation, securitization-based credit intermediation and funding of financial entities. Each of these has three to six tools or standards, although there is no standardized reference number. The language used is general rather than specific, reflecting large differences among countries.

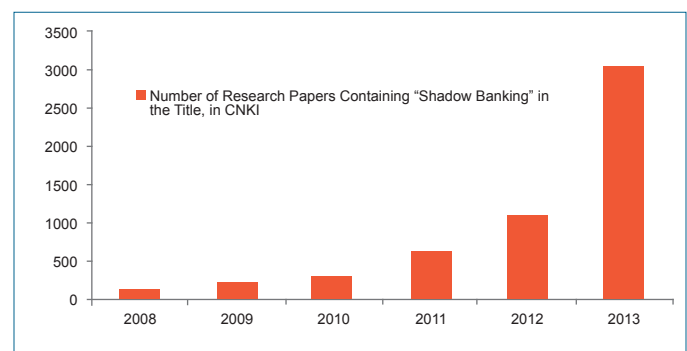
Chinese regulatory authorities are generally supportive of the tool kits and the related common standards set by WS3. However, their views of particular regulatory tools and indicators vary for a few reasons. First, China's shadow banking system has particular characteristics that diverge from the FSB definition. Second, its regulatory system and architecture are also distinct from those of advanced markets, which are the benchmarks for the FSB framework. While some of the FSB's tools and

standards are therefore less pertinent to the Chinese situation, China supports their implementation in advanced economies.

China's regulatory authorities are also under great political pressure to establish a sound regulatory system to deal with the potential risks. The Third Plenary Session of the 18th National Congress of the Communist Party of China, held in November 2013, required the regulatory authorities to resolve that regional or systemic financial crisis will not happen in China. The regulators have thus been eager to learn from the FSB, the IMF, developed countries and other emerging markets to build a comprehensive, effective and efficient regulatory system to keep the resolution made by the highest political leadership.

China's academic community has also witnessed a research boom in the field of shadow banking. According to the statistics of China National Knowledge Infrastructure (CNKI), the number of research articles on shadow banking has expanded dramatically in the last several years, from 114 in 2008 to 3,015 in 2013 (Figure 1). More than 50 percent of the papers are concerned with the development of shadow banking in foreign countries and the regulation practices of foreign regulatory authorities and international organizations. The regulatory implications for China have been a common topic in the above articles. Zhou Xiaochuan (2011), the governor of the PBoC, pointed out that the macroprudential management framework should cover all financial entities, activities and infrastructures, including the shadow banking system, and be subject to standards of capital, liquidity, leverage and provisions.

Figure 1: The Number of Research Papers Containing "Shadow Banking" in the Title, in CNKI



Source: CNKI (2014).

3 The standing committee set five workstreams to conduct different recommended frameworks for regulation reforms of financial markets. Workstream Three (WS3) on Non-bank Financial Entities Other than MMFs ("other shadow banking entities") is responsible for setting a monitoring and regulatory framework for the global shadow banking system. China is a member of WS3.



# The Shadow Banking System of China and Its Regulation

## A Different Definition

Domestic researchers and policy makers in China hold differing opinions on the definition of shadow banking, which can be categorized into three points of view: defining it in terms of whether it is subject to regulation, whether it can cause systemic financial risk, and whether it is non-traditional credit financing as opposed to traditional banking credit.

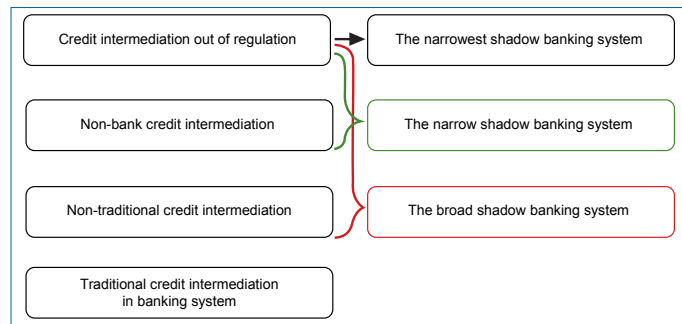
With regard to the second point of view, Andrew L. T. Sheng (2010) has stressed that the macroscopic, structural and microscopic issues of shadow banking may cause major financial risk. This view focuses more on the contagiousness and interrelatedness of risks in the financial system.

The third perspective emphasizes the role of non-traditional credit financing as the core of shadow banking, and its innovation and difference compared with credit intermediaries in the traditional banking system. Yang Li (2013), and Bin Hu and Liansheng Zheng (2014) discuss the inevitability and risks of the development of non-traditional credit financing or shadow banking from the perspective of financial innovation. Although subjection to regulation is not the core criterion for shadow banking in this definition, it follows a similar logic to the FSB's monitoring and regulatory framework<sup>4</sup> (based on non-bank financial intermediation), except that non-traditional credit intermediation covers a broader scope than non-bank credit intermediation. The only essential difference between non-traditional credit intermediation and non-bank credit intermediation is that some part of inter-bank funding is included in the former. Because some banks have conducted credit expansion through the inter-bank funding market, we call it the "Bank's Shadow."

Taking into account the FSB's definition and the characteristics of China's financial system, the shadow banking system of China can be defined on three levels from the perspective of non-traditional credit intermediation. The base level is the narrowest sense of shadow banking, corresponding to the domestic definition based on whether it is subject to regulation. The second level is the narrow sense of shadow banking, corresponding to credit intermediation outside the banking system (non-bank credit intermediation). The third level is the broad sense of the shadow banking system, encompassing the narrow sense of shadow banking and non-traditional credit financing inside the banking system (or Bank's Shadow).

4 The initial definition given by the FSB uses subjection to regulation as the criterion to define shadow banking system, but the monitoring and regulatory framework set by the FSB focuses on non-banking credit entities and/or activities based on economic functions of the shadow banking system. In my view, the FSB has paid more attention to the functions of the shadow banking system rather than to whether the system is regulated or not.

Figure 2: The Shadow Banking System of China



Source: Hu and Zheng (2014).

Hu and Zheng (2014) estimated the scale of non-traditional financing involved in the shadow banking system in its narrowest sense to be ¥6 trillion and in its narrow sense to be ¥21 trillion by the end of the third quarter of 2013 (Table 1).<sup>5</sup> The scale of non-traditional credit financing involved in the shadow banking system in the broad sense was about ¥27 trillion, and the proportion of the total assets of the banking system was about 19 percent, or 47 percent of GDP.<sup>6</sup> The FSB estimated that the amount of China's shadow banking by the end of 2013 was about US\$3 trillion, or about ¥18.5 trillion.

## A Different Essence

In terms of scale, the assets of China's shadow banking system, even if defined in the broad sense, account for only about 20 percent of the total assets of the banking industry. Nonetheless, the development of the shadow banking system has substantially changed China's banking-dominated financial industry, as well as the structure of risks in China's financial system. The core risks, regulatory policies, development strategy and complementary reform measures of China's shadow banking system are more important than its scale. Currently, on-balance-sheet risks are the key focus, as they greatly increase the interrelatedness of risks.

The scale of shadow banking is not the most important issue. First of all, it is difficult to determine the scale of China's shadow banking with accuracy due to the limitations of the current statistical scope and the design of accounting items on financial institutions' balance sheets. The present calculations

5 The scale of China's non-banking credit intermediaries calculated by the FSB is US\$2.1 trillion, which is about ¥12.8 trillion, or 22.5 percent of GDP in 2013, much smaller than our statistics. The main reason for this discrepancy lies in the exclusion of a part of trust assets and some other businesses in the FSB's statistics.

6 Yan and Li (2014) estimate that the shadow banking system of China in 2012 was ¥20.7 trillion (not including wealth management products through trust companies, but including loans through trust companies), or 39.8 percent of GDP. Yan is the vice president of the CBRC and Li was the director-general of the Non-bank Financial Institutions Supervision Department of the CBRC. The Financial Stability Report of the IMF estimated (through the total social financing statistics) the shadow banking system of China to be about 35 percent of GDP in March 2014.

Table 1: The Three Levels of China's Shadow Banking System

	Characteristics	Non-traditional credit financing activities involved	Estimated scale (¥ trillion)
<b>The narrowest sense</b>	Unregulated or unlicensed	Private lending, third-party money management, online credit financing, unregistered private equity funds, small loans, financing guarantees	6
<b>The narrow sense</b>	Credit intermediation outside the banking system, including the narrowest items	Products involved in the narrowest sense of shadow banking, plus money management, trust, finance companies, MMFs, asset management for clients, financing business of funds and insurance subsidiaries, asset securitization, etc.	21
<b>The broad sense</b>	Non-traditional credit financing within the banking system, plus the narrow sense items	Inter-bank business for credit expansion, and a small portion of letter-of-credit drafts, and payment services	27

Source: Hu and Zheng (2014).

are all estimates and double counting is inevitable. What's more, changes in the scale of shadow banking reflect more of the structural changes from bank-dominated indirect financing to diversified means of financing, but fail to naturally reveal the risk accumulation and systemic risks of the whole financial system. The scale is mainly related to the quantity of financial risks, whereas the true risks of shadow banking, especially the on- and off-balance-sheet risks of banks and other institutions, reside in the quality.

Credit expansion based on inter-bank business (Bank's Shadow) is the key to the risks of China's shadow banking system. According to Ben Bernanke (2012), "An important feature of shadow banking is the historical and continuing involvement of commercial banks — that is, more 'traditional' banking institutions." Theoretical studies and practical research have revealed several aspects in which the financial risks of China's inter-bank business are manifested. The rapid expansion of inter-bank business produces essential changes in the risk structure of the banking system, broadens the scope of credit funding and changes its direction. At the same time, it conceals the credit risks of some banking businesses, increases leverage in the banking system and undoubtedly intensifies the interconnectivity within the banking system. It also results in stronger contagiousness of financial risks and leads to greater potential systemic risks than the bank-dominated system.

Against the background of rapid expansion of inter-bank business, the risks of shadow banking first manifest as liquidity risk in the money market. As non-traditional credit financing within the banking system relies more on the wholesale money market, the maintenance of the severe maturity mismatch in

the inter-bank business in particular is achieved through the wholesale inter-bank lending market. Due to the liquidity fluctuation of the wholesale market, liquidity is rather weak. Once risks erupt in the lending market, banks or other financial institutions that rely heavily on the wholesale money market will face a liquidity crisis, which will further induce contract violation and credit crisis, and may ultimately lead to a balance-sheet crisis in the banking system — in other words, banks' bankruptcy. The "money drought" incident on June 20, 2013, was a clear signal of the liquidity risks of shadow banking.<sup>7</sup>

The risks of the shadow banking system can easily create systemic financial risks. Maturity mismatch, rate of return mismatch and information asymmetry will ultimately produce liquidity risks, credit defaults and moral hazard. These risks mainly consist of incomplete infrastructure, information asymmetry and overdraft of institutional credit. Domestic financial institutions still do not have a clear understanding of these risks, and the lack of understanding of the "rationality of individual versus fallacy of composition" mismatch may result in an addiction-like interest in non-traditional credit financing. The other issue is that as inter-bank business develops rapidly, relatedness within the financial system increases. China's shadow banking system involves several industries, including banks, trusts, securities firms and insurance companies, and spans several financial markets of money, credit, capital, insurance and wealth management, which has led to an exponential growth of interconnectivity and risk contagion among financial institutions and within

<sup>7</sup> On June 20, 2013, due to the liquidity problem, the overnight inter-bank offering rate of China was as high as 13.44 percent, and peaked at over 30 percent during the trading session.

the financial system. Once a large risk arises within shadow banking, it may spread rapidly to the banking sector and the real economy through the money market and the credit market, and induce systemic financial risks. In a sense, interconnectivity and contagion are the largest hidden dangers of systemic risks, as well as the most precarious component of China's financial system.

## An Analogous Logic: China's Shadow Banking Regulation System

### Regulation of Wealth Management Products

In the last several years, China's wealth management products<sup>8</sup> have grown rapidly, from less than ¥500 billion in 2004 to ¥9.5 trillion by the end of 2013 (PBoC 2014).<sup>9</sup> Some financial institutions in the banking industry transferred existing loans and new loans off balance sheet by means of financial innovation, especially through the design and distribution of credit-type wealth management products. This was to evade regulations for capital requirements, provisions and loan supply plans, and became a shadow banking business. It can be seen that bank loans were transferred out of the balance sheet, while banks continued to assume the responsibilities of post-loan management, loan recovery and other substantial legal responsibilities and risks. But, as a result, capital requirements are decreased and corresponding provisioning is circumvented. The potential risks of such balance-sheet transfer cannot be overestimated.

In 2008 and 2009, when wealth management products developed in leaps and bounds, the CBRC carried out targeted regulation of financial risks caused by the products, with a focus on reporting and investment management by wealth management services. During the release and implementation of specific regulatory documents, related regulatory departments made full use of the flexibility of the regulatory framework. They devised and implemented policies that were pertinent, timely and effective, to regulate the development, changes and risk distribution of banks' wealth management market, and they handled well the balance between development and stability on the basis of encouraging development and preventing risks at the core.

The core objective of regulation for wealth management products is to control liquidity and maturity risks. The CBRC has required that the ratio of non-standard assets to the total assets of wealth management portfolios cannot exceed 30 percent. As well, the ratio of wealth management portfolios of any given bank to the total assets of the bank cannot exceed four percent. The regulatory authorities also require every management product to have its own balance sheet for information disclosure. Because of the essential differences of wealth management products from collective investment vehicles, the tools for managing redemption pressures and limits on leverage, the other two recommended tool kits to deal with the risks of collective investment vehicles of the FSB have not yet developed significantly in China.

### Regulation of Trust-based Lending

Following relatively effective risk control of commercial banks' wealth management services, the expansion of their services slowed down. Meanwhile, following a period of tight monetary policy from 2010 to 2011, the scale of bank-based credit financing was controlled to a limited degree, so the wealth management cooperation (as a new financing channel) between banks and trust companies developed quickly. Through the introduction of trust plans, bank-trust wealth management cooperation was able to evade related regulations and became trust-based lending,<sup>10</sup> another important model of China's shadow banking system. With the rapid growth of bank-trust cooperation, the trust industry became the second largest subsector of China's financial system in 2012, with total assets of ¥7.47 trillion, up from ¥1.24 trillion in 2008. The total assets of the trust sector were ¥12.48 trillion by June 2014.

Since 2010, trust-based lending has become another regulatory category for authorities. Bank-trust cooperative credit financing underwent explosive growth, and might now pose relatively large macroeconomic and financial risks. In August 2010, the CBRC strengthened regulations of bank-trust wealth management cooperation, brought in "ratio management" (financial business must be no larger than 30 percent), restrained non-listed companies' equity investment products, and required commercial banks to transfer off-balance-sheet assets onto balance sheets and take provision into account within two years. On January 13, 2011, the CBRC implemented new regulations of bank-trust wealth management cooperation, clarified the risk attribution of bank-trust wealth management cooperation and required off balance sheet of bank-trust wealth management cooperation business to transfer onto balance sheets by the end of 2011. For cooperative trust loans of commercial banks and

<sup>8</sup> Wealth management products are similar to the collective investment vehicles of the FSB monitoring and regulatory framework, although they also have some essential differences; for example, wealth management products in China are regulated by the regulatory authorities. However, some wealth management products have full or partial economic functions of the shadow banking system as defined by the FSB.

<sup>9</sup> The Financial Stability Report of the IMF estimates that the value of wealth management products in China was more than ¥14 trillion as of March 2014, or about 26 percent of GDP (IMF 2014).

<sup>10</sup> The IMF calls them entrusted loans and trust loans (IMF 2014). Entrusted loans are loans between firms, with banks or finance companies as payment agents. A great number of wealth management products introduced in the above section are actually entrusted loans. Trust loans are loans by trust companies that in turn structure these loans into trust schemes or wealth management products and sell them to investors.

trust companies that were not transferred to on-balance-sheet, trust companies had to make risk provisions of 10.5 percent.

The stipulation of “ratio management,” the requirement of transferring off-balance-sheet to on-balance-sheet, and the risk provision facility are reflective of the same regulatory logic as the FSB. The CBRC has established a comprehensive regulatory framework (the so-called No. 99 Document) to monitor and supervise the potential risks of the trust sector, particularly trust-based lending since April 2014 (CBRC 2014b). Liquidity risks, capital requirements and market-based recovery and resolution are the main focuses. The liquidity and capital policies are similar to the tool kits of the FSB. The CBRC is also considering a liquidity buffer mechanism, strongly recommended by the FSB, although it is building up a stabilization fund to mitigate the impact of increased redemptions in the event of market distress.

### The Regulation of Non-traditional Credit Intermediation

Following the rather effective regulation of such non-traditional credit financing services as bank-trust cooperation, wealth management and banknotes, the non-traditional credit expansion has become a new innovation of the shadow banking system since 2012 and has become the third main model of China’s shadow banking system, regarded as the Bank’s Shadow. Some banks use short-term borrowing from the inter-bank market to supply long-term loans in cooperation with trust companies and other third parties. These inter-bank business assets were above ¥12 trillion by the end of 2013, half of which might be credit expansion activities as defined by the FSB.

In considering how inter-bank business became a central focus of regulation, the incident of “money drought” on June 20, 2013, comes to mind. Many research findings hold that the sharp increases of liquidity risks, caused by the excessive expansion of inter-bank businesses with reverse repo as the main business, was one of its origins. Shang Fulin, chairman of the CBRC, indicates there were deficiencies in the liquidity administration and business structure of commercial banks, and the CBRC was working on documents to regulate inter-bank business.

In May 2014, the regulatory authorities — that is, the PBoC, the CBRC, the China Securities Regulatory Commission, the China Insurance Regulatory Commission and the State Administration Foreign Exchange — developed a framework to regulate the inter-bank credit financing entities and/or activities. Although the non-traditional credit activities of the traditional banks are not defined as shadow banking business by the FSB, China’s regulatory authorities have learned much from the policy tool kits of the FSB. In the regulatory framework of inter-bank credit expansion, there are five areas of concern: third-party institutions cannot be involved in repurchasing financial assets between any other two financial institutions, for example, by providing guarantees to these two institutions; strengthening management of maturity mismatches; inter-bank business should be included in the unified credit management

authority and the total amount of the inter-bank lending should not exceed 50 percent of tier-one capital; inter-bank credit expansion should be subject to the provision mechanism; and the maturity of inter-bank lending should not exceed three years. It is clear that the regulatory standards of interconnectedness, maturity, liquidity, provision and asset concentration are more strict and explicit than those of the FSB.

### China’s Regulatory Practices and International Coordination

As noted above, China’s attitude to international cooperation and coordination in regulation of shadow banking has been open and inclusive. To some extent, politics have been subdued and the approach has been pragmatic. The main concern is whether the international framework established by the international community is suitable for China’s circumstances.

China is an active member of the FSB’s Standing Committee on Supervisory and Regulatory Cooperation. At its 10th meeting, held in London on January 31, 2012, China put forward four suggestions on the regulation of shadow banking and the five-workstream plan, considering the fundamental aims, effective policy tool kits, a clear agenda and differences among member countries. After that, China joined WS3 to cooperate with and coordinate the regulation of non-bank intermediation entities and activities. In this process, China insisted on three fundamental principles. First, due to the great differences among involved countries, WS3 should respect the judgments and standards of national regulatory authorities based on the economic functions defined by the FSB and the reality of different countries. Second, besides regulating the shadow banking system, it is necessary to control its counterpart, the regular banking sector. The BCBS should take account of the potential risks of the shadow banking system for the banking sector. Third, the monitoring and regulatory framework should have specific common principles, recommended policies and promulgated standards that can be used globally.

Chinese authorities have learned much in the process of international coordination. Although China did not agree with the FSB that China’s trust industry should be regarded as part of the shadow banking system, due to the strict regulation of this sector, the regulatory framework of Chinese trusts has still obeyed the common principles of the FSB and even utilized some policy tools recommended by the FSB. The agreement between China and the international regulatory community is to better understand the dynamic development of regulation of this sector, to better absorb other experiences and to achieve more comprehensive, effective and efficient regulation. The fundamental and shared objectives have been to mitigate spillover effects and systemic risks and to maintain financial stability. This has helped to sustain the momentum for financial reform in China.

The huge differences between China’s shadow banking system and those of advanced countries make it very difficult to achieve



further progress in international coordination. It will be difficult for China to agree on particular regulation standards in non-bank credit entities and activities. For example, China's trust companies and securities brokerages are quite different from those of advanced financial markets. Trust-based lending has lower leverage than in Western countries, and it has a strong relationship with the debt of local governments. To implement FSB standards, China would have to reform its fiscal and taxation framework because the debt problem of local governments in China has institutional origins, that is, the tax-sharing system between the central government and local governments. The bad debt of local governments accumulated in the shadow banking system cannot simply be socialized through so-called deeper reform (Pettis 2014). In short, the essential reason China cannot accept some specific international standards is that the leadership worries this would require domestic reforms for which it is not yet ready.

Internal coordination problems in China can also create an obstacle to international cooperation in financial regulation. Since the financial crisis, the PBoC has paid great attention to financial stability and tried to build up a macroprudential policy framework. This creates the potential for conflict with other domestic financial regulators. For example, the central bank and the CBRC held different views on how to regulate the inter-bank business market. These regulators, holding different standpoints, can agree on general principles only rather than specific policy recommendations and policy tool kits, which can limit China's ability to coordinate internationally. Fortunately, after the interministerial joint conference mechanism of financial regulation established on August 25, 2013, the internal coordination process has improved significantly. This should in turn promote the effectiveness of international cooperation in financial regulation, including the regulation of the shadow banking system.

## Conclusions and Policy Suggestions

Although the shadow banking system was described for the first time only in 2007, the related non-banking credit entities and activities have long played an important role in the financial system of advanced countries such as the United States and the United Kingdom, and were a root cause of the most serious international financial crisis since the Great Depression.

The development of regulation of the shadow banking system after the financial crisis has two aspects. First, regulatory reforms in advanced markets, such as the United States, the United Kingdom and the European Union, have established a macroprudential policy system including a regulatory framework for the shadow banking system. Second, international cooperation and coordination have achieved much in a short period. The FSB has built a sound monitoring and regulatory framework for the global shadow banking system and has published four oversight reports since 2012.

However, bilateral and multilateral cooperation between advanced economies and emerging markets have made little fundamental progress. The dynamic interests and changing attitudes of the developed economies, the following strategy and neutral position of much of the developing world, the great differences of financial markets, the soft-law status of international standards, and the professional, technical and linguistic weaknesses of emerging countries are the main contributors to this outcome.

As for China, it has witnessed rapid growth of the shadow banking sector in the last several years. Its attitude to international coordination in regulation of the shadow banking system has changed from a following strategy to a constructive, inclusive and pragmatic approach. This distinguishes it from many developing countries. China's main objective is to establish a comprehensive regulatory framework for the shadow banking system through deeper and further cooperation in the future. However, further international coordination between China and the international community needs to overcome particular challenges, such as differences of financial institutions, governance structures and legal systems, the applicability of international regulation standards in China and some specific weaknesses of China.

### A Third-party Consultant Committee

A third-party consultant committee would help to enhance international coordination in financial regulation of non-bank credit entities and activities. The consultant committee should also be organized and managed by the FSB, while its members might be more diversified. Leading scholars in financial regulation from advanced markets and emerging countries should be invited to sit on this consultant committee. The committee would have two main responsibilities. First, it would have the power to review the coordination of financial regulation, particularly the regulation of the banking sector and the shadow banking system, and provide review reports to the FSB and G20 leaders. Second, the committee would conduct specific research projects and provide fundamental materials and suggestions to strengthen international coordination. The committee would establish regulatory indicators and standards from a global perspective.

### Further Improvement of the FSB's Regulatory Framework

The FSB should take further actions to improve its monitoring and supervision framework to enhance international cooperation and coordination in the regulation of shadow banking. Its first job is to arrive at an integrated picture of the details of the global shadow banking system, such as related entities, financial products, markets and the relationship between the shadow banking system and the regular banking system of individual countries. It is vital to distinguish the essential differences between the shadow banking systems of advanced markets and those of emerging markets, but also to

make clear the commonalities of each. The common entities and activities should be subject to common, specific regulatory requirements. The different businesses of these two systems might be regulated by the common principles of the FSB, while every country should be required to set up a regulatory framework for its own shadow banking system. The FSB should strengthen its monitoring and regulation capacities to improve its credibility, accountability and authoritativeness. In particular, the FSB needs to improve its policy tool kits. Finally, the FSB should enhance its cooperation and coordination with other international financial organizations, such as the IMF, the Bank for International Settlements and Asia-Pacific Economic Cooperation presidential countries, and important national regulatory authorities including the US Fed, the ECB, the Bank of England and regulators from Brazil, China and India.

### Capacity Building

Improving the regulatory capacity of emerging markets is fundamental. The FSB, the IMF and other related international organizations should take specific actions to help emerging markets to establish a regulatory framework based on the monitoring and oversight framework of the FSB. In addition, the FSB should improve basic regulatory capacity through various research and training programs. For example, it is difficult for some emerging countries to collect data on the shadow banking system because statistical agencies have no related knowledge, skills or software. The professionals of advanced markets might help the regulatory authorities from less developed countries to improve their capacity in research, statistics and policy making.

### An Information-sharing System

Finally, it is necessary to establish an information-sharing system as soon as possible. One of the causes of limited progress in the regulation of shadow banking is that the FSB does not have a comprehensive information system for global non-bank credit entities and activities. This should be an urgent priority.

## Acknowledgements

The research was supported by the Institute for New Economic Thinking, CIGI and the National Social Science Foundation of China. I am indebted to Andrew Walter from the University of Melbourne, Hu Bin from CASS, Wang Gang from the Development Research Center of the State Council of China and Kuang Keke from the Institute of World Economics and Politics. I wish to thank all team members and participants in the seminar at the University of Melbourne on October 31, 2014, for their valuable comments and discussion on an outline and earlier version of this paper.

## Works Cited

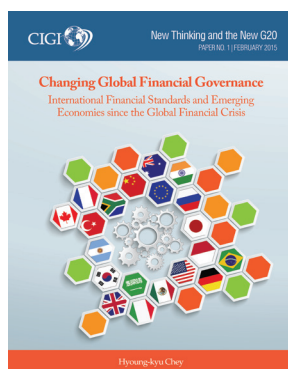
- Sheng, Andrew L. T. 2010. "Keep an Eye on Shadow Banking." [In Chinese.] *New Century* 5. December.
- Bernanke, Ben. 2012. "Fostering Financial Stability." Speech given at the Federal Reserve Bank of Atlanta Financial Markets Conference, April 9.
- CBRC. 2014a. *Annual Report 2013*. June 16.
- CBRC. 2014b. *The Guidance on Risk Supervision to Trust Companies*. April 8.
- CNKI. 2014. "The Number of Research Papers Containing 'Shadow Banking' in the Title." August 30. [http://epub.cnki.net/kns/brief/default\\_result.aspx](http://epub.cnki.net/kns/brief/default_result.aspx).
- ECB. 2012. "Shadow Banking in the Euro Area: An Overview." Occasional Paper 133. April.
- Evans-Pritchard, Ambrose. 2014. "Bank of England's Mark Carney sees shadow banking in emerging market as biggest global risk." *The Telegraph*, December 13.
- FSB. 2011. *Shadow Banking: Strengthening Oversight and Regulation*. October 27.
- . 2013. *Global Shadow Banking Monitoring Report 2013*. November 14.
- . 2014. *Global Shadow Banking Monitoring Report 2014*. October 30.
- G20 Leaders' Communiqué. 2014. Brisbane Summit. November 15-16. [https://g20.org/tr/wp-content/uploads/2014/12/brisbane\\_g20\\_leaders\\_summit\\_communique1.pdf](https://g20.org/tr/wp-content/uploads/2014/12/brisbane_g20_leaders_summit_communique1.pdf).
- G20 Leaders' Declaration. 2008. Washington Summit. November 14-15. [https://g20.org/wp-content/uploads/2014/12/Washington\\_Declaration\\_0.pdf](https://g20.org/wp-content/uploads/2014/12/Washington_Declaration_0.pdf)
- . 2013. St. Petersburg Summit. September 5-6. <http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>
- Geithner, Timothy F. 2008. "Reducing Systemic Risk in a Dynamic Financial System." Speech given at the Economic Club of New York, New York City, June 9.
- Hu, Bin and Zheng Liansheng. 2014. "The Shadow Banking System: In a Non-traditional Credit Intermediation Perspective." [In Chinese.] In *China Annual Financial Regulation and Supervision Report*. Social Sciences Academic Press, May.
- IMF. 2014. *Global Financial Stability Report*. Washington, DC: April 9.
- Li, Yang. 2013. "Don't Regulate Shadow Banking in a Rude Way." [In Chinese.] *China Securities Journal*, July 19.
- National Bureau of Statistics of China. 2014. [www.stats.gov.cn](http://www.stats.gov.cn).
- PBoC. 2014. *China Monetary Policy Report*. February 8.
- Pettis, Michael. 2014. "Will the Reforms Speed Growth in China?" *Michael Pettis' China Financial Markets* (blog), January 5. <http://blog.mpettis.com/2014/01/will-the-reforms-speed-growth-in-china/>.
- Sinha, Anand. 2013. "Regulation of Shadow Banking—Issues and Challenges." Paper presented at an event organized by the Indian Merchants' Chamber, Mumbai, January 7.
- The Economist*. 2014. "The Lure of Shadow Banking." *The Economist*, May 10.
- Yan, Qingmin and Li Jianhua. 2014. *China's Shadow Banking System and its Regulation*. [In Chinese.] Beijing, China: China Renmin University Press.
- Xiao, Gang. 2012. "Regulating Shadow Banking." *China Daily*, October 12.
- Zhou, Xiaochuan. 2011. "On the Response of Financial Policy to the Financial Crisis: The Background, Logic and Main Contents of Prudential Macroeconomic Policy Framework." [In Chinese.] *Journal of Financial Research* 1 (367).



# CIGI Publications

## Advancing Policy Ideas and Debate

### New Thinking and the New G20 Paper Series



These papers are an output of a project that aims to promote policy and institutional innovation in global economic governance in two key areas: governance of international monetary and financial relations and international collaboration in financial regulation. With authors from eight countries, the 11 papers in this series will add to existing knowledge and offer original recommendations for international policy cooperation and institutional innovation.

**Changing Global Financial Governance:**  
International Financial Standards and Emerging Economies since the Global Financial Crisis  
*Hyoung-kyu Chey*

**Internationalization of the Renminbi:**  
Developments, Problems and Influences  
*Ming Zhang*

**Capital Flows and Capital Account Management in Selected Asian Economies**  
*Rajeswari Sengupta and Abhijit Sen Gupta*

**Emerging Countries and Implementation:**  
Brazil's Experience with Basel's Regulatory Consistency Assessment Program  
*Fernanda Martins Bandeira*

**The Shadow Banking System of China and International Regulatory Cooperation**  
*Zheng Liansheng*

**Emerging Countries and Basel III:**  
Why Is Engagement Still Low?  
*Andrew Walter*

**Financial Inclusion and Global Regulatory Standards: An Empirical Study Across Developing Economies**  
*Mariana Magaldi de Sousa*

**International Regulatory Cooperation on the Resolution of Financial Institutions: Where Does India Stand?**  
*Renuka Sane*

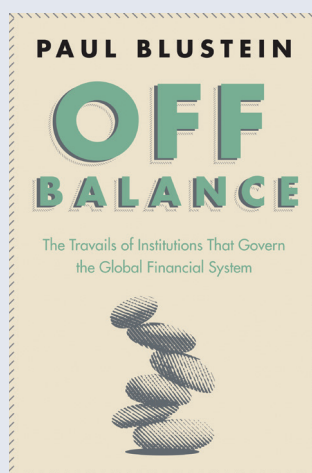
**Capital Flows and Spillovers**  
*Sebnem Kalemli-Ozcan*

**The Global Liquidity Safety Net: Institutional Cooperation on Precautionary Facilities and Central Bank Swaps**  
*C. Randall Henning*

**Capital Controls and Implications for Surveillance and Coordination: Brazil and Latin America**  
*Marcio Garcia*

### CIGI Books

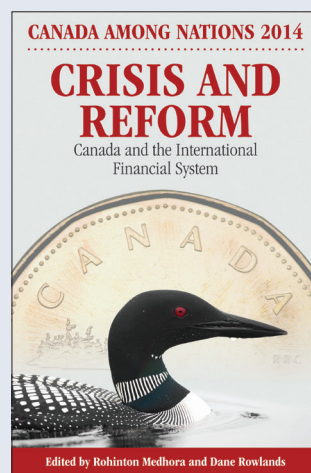
Available for purchase directly from [www.cigionline.org/bookstore](http://www.cigionline.org/bookstore)



**Off Balance: The Travails of Institutions That Govern the Global Financial System**  
*Paul Blustein*

Paperback: \$28.00;  
eBook: \$14.00

The latest book from award-winning journalist and author Paul Blustein is a detailed account of the failings of international institutions in the global financial crisis.

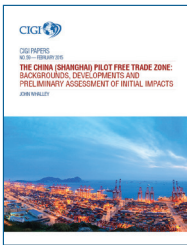


**Crisis and Reform: Canada and the International Financial System**  
*Edited by Rohinton Medhora and Dane Rowlands*

Paperback: \$32.00;  
eBook: \$16.00

The 28th edition of the Canada Among Nations series is an examination of Canada and the global financial crisis, and the country's historic and current role in the international financial system.

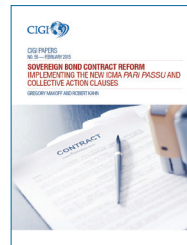




## The China (Shanghai) Pilot Free Trade Zone: Backgrounds, Developments and Preliminary Assessment of Initial Impacts

*CIGI Papers No. 58*  
*John Whalley*

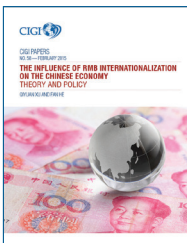
The China (Shanghai) Pilot Free Trade Zone (SPFTZ), founded in September 2013, has promised liberalization on capital account and trade facilitation as its main objectives. This paper discusses reasons why China needs such a pilot zone after three decades of economic development, examines the differences between the SPFTZ and other free trade zones and highlights the developments of the SPFTZ since its inception. The hope is that the success of the SPFTZ will give rise to a more balanced Chinese economy in the following decade.



## Sovereign Bond Contract Reform: Implementing the New ICMA *Pari Passu* and Collective Action Clauses

*CIGI Papers No. 56*  
*Gregory D. Makoff and Robert Kahn*

The International Capital Market Association (ICMA) has recently published proposed standard terms for new, aggregated collective action clauses. Concurrently, the ICMA released new model wording for the *pari passu* clause typically included in international sovereign bond contracts. These announcements and the commencement of issuance of bonds with these clauses are an important turning point in the evolution of sovereign bond markets.



## The Influence of RMB Internationalization on the Chinese Economy

*CIGI Papers No. 57*  
*Qiyuan Xu and Fan He*

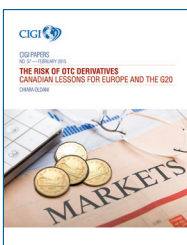
Since China's pilot scheme for RMB cross-border settlement was launched in 2009, it has become increasingly important for monetary authorities in terms of macroeconomic policy frameworks. The authors use an analytical model that includes monetary supply and demand to examine the influences of RMB cross-border settlement on China's domestic interest rate, asset price and foreign exchange reserves. They also look at how RMB settlement behaves in different ways with the various items in China's balance of payments.



## Completing the G20's Program to Reform Global Financial Regulation

*CIGI Papers No. 55*  
*Malcolm D. Knight*

The measures regulators have largely agreed on for a strengthened and internationally harmonized financial regulatory regime, which were endorsed at the 2014 G20 leaders summit in Brisbane, are a major step toward achieving a robust and less crisis-prone global financial system. There are, however, a number of specific measures that need to receive closer attention in order for the G20 leaders to declare their reform program a success. This paper discusses what policy makers and regulators should focus on in 2015 and why closer international cooperation in implementing regulatory reforms will be essential for success.



## The Risk of OTC Derivatives: Canadian Lessons for Europe and the G20

*CIGI Papers No. 53*  
*Chiara Oldani*

Over-the-counter (OTC) derivatives played an important role in the buildup of systemic risk in financial markets before 2007 and in spreading volatility throughout global financial markets during the crisis. In recognition of the financial and economic benefits of derivatives products, the G20 moved to regulate the use of OTC derivatives. Attention has been drawn to the detrimental effects of the United States and the European Union to coordinate OTC reform, but this overlooks an important aspect of the post-crisis process: the exemption of non-financial operators from OTC derivative regulatory requirements.



## The Trade in Services Agreement: Plurilateral Progress or Game-changing Gamble?

*CIGI Papers No. 52*  
*Patricia M. Goff*

Trade analysis in the current moment is understandably focused on mega-regional negotiations, but plurilateral talks also deserve our attention. Plurilateral negotiations leading to a Trade in Services Agreement (TiSA) is the focus of this paper. Barriers to trade in services are distinct and their removal consequential; thus inviting careful consideration and, ideally, public debate. This paper seeks to illuminate developments in negotiations toward the plurilateral TiSA. Just as it has become commonplace to ask whether regional agreements advance economic and political agendas, so is it useful to explore the promise and peril of plurilateral agreements such as TiSA.

## About CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI's current research programs focus on three themes: the global economy; global security & politics; and international law.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion (BlackBerry). Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l'appui reçu du gouvernement du Canada et de celui du gouvernement de l'Ontario.

For more information, please visit [www.cigionline.org](http://www.cigionline.org).

## CIGI Masthead

**Managing Editor, Publications**

Carol Bonnett

**Publications Editor**

Jennifer Goyder

**Publications Editor**

Vivian Moser

**Publications Editor**

Patricia Holmes

**Publications Editor**

Nicole Langlois

**Graphic Designer**

Melodie Wakefield

**Graphic Designer**

Sara Moore

### Executive

**President**

Rohinton Medhora

**Vice President of Programs**

David Dewitt

**Vice President of Public Affairs**

Fred Kuntz

**Vice President of Finance**

Mark Menard

### Communications

**Communications Manager**

Tammy Bender [tbender@cigionline.org](mailto:tbender@cigionline.org) (1 519 885 2444 x 7356)







67 Erb Street West  
Waterloo, Ontario N2L 6C2, Canada  
tel +1 519 885 2444 fax +1 519 885 5450  
[www.cigionline.org](http://www.cigionline.org)

