GROUP OF THIRTY
Consultative Group on International Economic & Monetary Affairs, Inc.

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Group of Thirty Study Highlights Risks to Financial System Posed by Global Debt Levels and New Forms of Credit Extension

Rise of Shadow Banking Activities, including those in China, Merit Close Scrutiny

PARIS—November 16, 2016: Eight years on from the peak of the global financial crisis, the specific forms of nonbank credit intermediation most implicated in the crisis have declined in response to tighter bank regulation, but the continued growth of global debt levels and new forms of credit extension are creating new risks to the financial system that may be equal to those in place before the crisis, the Group of Thirty (G30) said today.

The G30, a forum of leaders in international finance, today released *Shadow Banking and Capital Markets: Risks and Opportunities*, the report of their two-year study of shadow banking, a phenomenon defined by the Financial Stability Board as "activities related to credit provision extended outside or partially outside the banking system, but involving the distinctive features of banking, that is, leverage and maturity transformation." The report also details the G30's examination of shadow banking in China, where some 30 percent of credit is provided via a multiplicity of unregulated or imperfectly regulated shadow banking activities, entities, and structures, some of which are similar to those that proliferated in the advanced economies before the 2007-08 crisis.

"While our study found that regulatory actions taken by financial institutions around the globe have lowered risks in some key areas of shadow banking and securitization, financial stability risks remain elevated in some markets—including China—as capital markets shift and overall global debt levels rise," said **Jean-Claude Trichet,** G30 Chairman and former President of the European Central Bank. "This is no time for complacency. National policy makers and regulators must monitor the continually evolving nature of financial markets to spot the risks created by new forms of financial intermediation."

Adair Turner, Chairman of the Governing Board at the Institute for New Economic Thinking, former Chairman of the Financial Services Authority, and Steering Committee Chair of the G30 Working Group on Shadow Banking, added: "We caution that as the overall level of leverage in the global economy continues to grow, financial and macroeconomic risks could increase even if the financial intermediation system has become more resilient. Overall, the risks arising from the combination of high leverage and the particular ways in which credit is intermediated may be as great as before the 2007-08 financial crisis, even if in advanced economies the financial system itself is less susceptible to the sort of self-reinforcing shocks experienced in that crisis."

Mr. Turner chaired the study alongside two vice-chairs, **Jacques de Larosière,** President of Eurofi and former Managing Director of the International Monetary Fund, and **Masaaki Shirakawa,** Special Professor of International Politics, Economics and Communication at Aoyama Gakuin University and former Governor of the Bank of Japan. They were supported by eleven G30 members who comprise the G30 Working Group on Shadow Banking. **Susan Lund** of the McKinsey Global Institute served as project director.

The G30 study also assessed the common assertion that securitization could play a greater role--particularly in Europe--in providing credit to small and medium enterprises (SMEs), which are often believed to be underserved by the banking system. "Our research into opportunities for SME market financing revealed that contrary to the conventional wisdom, SME debt is primarily provided by banks rather than market mechanisms in all economies, including the United States," said **Jacques de Larosière. "**Differences between the US and other markets instead lie primarily in the areas of equity finance and debt private placement. We recommend, therefore, that policies to expand the range of financing opportunities available to SMEs should focus on identifying and removing any barriers to the effectiveness of those markets, rather than on the probably impossible task of unleashing SME securitization markets. Most SME debt finance must still be based on bank finance. But credit may, in some regions, be hampered by the low profitability of the banking sector inherent to the low interest rate environment."

The report also notes that central bank policy may be having unintended effects on shadow banking activities and new debt growth. **Masaaki Shirakawa** noted that, "Macroeconomic concerns remain due to the unintended consequences of loose monetary policy—this is another reason for vigilance, and it underscores the need to understand the linkages between shadow banking developments and central bank policy. A more wide-ranging debate is needed on the fundamental drivers of rapid debt growth. As part of this, policy makers should consider whether rapid debt growth is the product of monetary policy regime—the way in which monetary policy is operated. Further consideration needs to be given to the question of whether leverage beyond some level is bound to depress growth and produce instability, and if so, how monetary policy regime should be modified."

The report offers a series of specific recommendations focused on: (1) The need to monitor risk, improve data availability, and increase transparency in a continually evolving financial system; (2) Policy reforms that can help foster the development of debt capital markets; (3) Policies to support more sustainable forms of securitization than proliferated before the 2007–08 crisis; and

(4) Appropriate approaches to improving SME access to finance, which should focus on equity finance and private placement, rather than on the development of SME securitization markets.

The Group of Thirty, formally known as “The Consultative Group on International Economic and Monetary Affairs, Inc.” was founded in 1978. The Group of Thirty is a private, nonprofit, international body composed of senior representatives of the private and public sectors and academia. The Group aims to deepen understanding of international economic and financial issues, to explore the international repercussions of decisions taken in the public and private sectors, and to examine the choices available to market practitioners and to policymakers. The Group is led by Jacob A. Frenkel, Chairman of the Board of Trustees, and Jean-Claude Trichet, Chairman of the Group.

For more on the G30, and to download today's report, please go to www.group30.org.

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