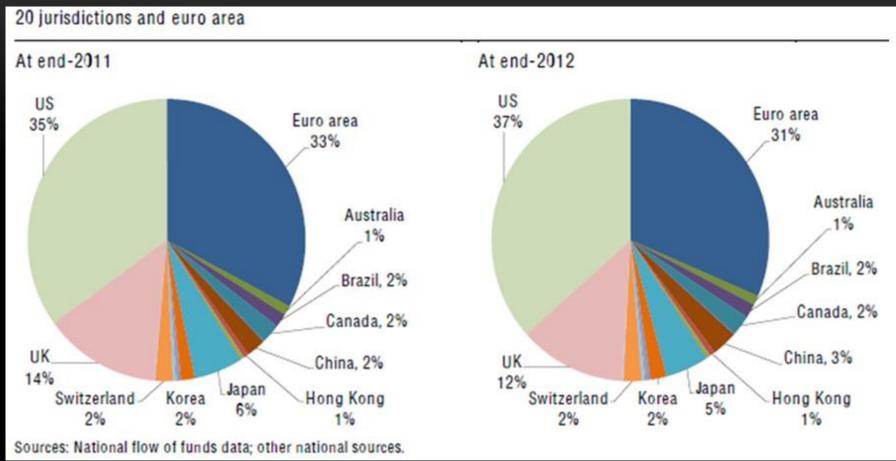
# "SHADOW BANKING" defined as: MONEY MARKET FUNDING of CAPITAL MARKET LENDING

ESMA SMSG meeting 2014-11-04/05

## Assets share of Non-Bank Fin. Intermediaries



\$72 trillion Market: the US has the largest system of non-bank financial intermediation at the end of 2012 with assets of \$26 trillion, followed by the euro area (\$22 trillion), the UK (\$9 trillion) and Japan (\$4 trillion).

#### Balance sheets: "SHADOW" vs TRADITIONAL Bank

Shadow Bank		Ba	Bank		
ABS IRS CDS FXS FXS	MM borrowing RP ED (Libor) ABCP	loans securities <u>cash</u>	deposits other borrowing capital		
liquidity	solvency	liquidity	solvency		

ABS: assets backed securities, ABCP :assets backed commercial paper, ED: Euro Dollar, CDS: Credit Default Swaps IRS: Interest Rate Swaps, FXS: FX Swaps,

## "SHADOW BANKING" - Definitions

#### **Activities and Entities Activities Entities** Claessens and Ratnovski McCulley (2007): Levered-up FSB (2013c): Credit (2014): All financial activities. financial intermediaries with intermediation involving entities except traditional banking. liabilities perceived akin to bank and activities outside the regular requiring private or public deposits ("the whole alphabet banking system backstop to operate soup") FCIC (2010): Unregulated or Schwarcz (2012): Provision of Ricks (2010): Maturity lightly regulated bank-like financial products and services transformation outside banking intermediation by shadow entities and financial social contract markets Mehrling and others (2013): Acharya, Khandwala, and Money market funding of capital Öncü (2013): Nonbank financial Gorton and Metrick (2012): market lending institutions that behave like Institutions, old contracts (repo), banks, borrow short, leverage, and more esoteric instruments and lend and invest long in (ABCP, ABS, CDO, and the like) Deloitte (2012): Marketilliquid assets, but less regulated funded, credit intermediation system involving maturity or Kane (2014): Entities with liquidity transformation through Pozsar and others (2013): securitization and liabilities supposedly redeemable Entities that conduct maturity, secured-funding mechanisms at par but without a government credit, and liquidity guarantee, and instruments that transformation without trade as if they have a zero government guarantee or access Harutyunyan and others performance risk to central bank liquidity (forthcoming): Noncore liabilities capturing nontraditional funding

Sources: See works cited in the Chapter 2 references.

Note: ABCP = asset-backed commercial paper; ABS = asset-backed security; CD0 = collateralized debt obligation; repo = repurchase agreement.

# "SHADOW" BANKING as a MARKET-BASED CREDIT

Securitization		Shadow Bank		MM Mutual Fund	
Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
ABS	Hi slice	Hi slice	RP	RP	"deposits"
	Mid slice Lo slice	Liquidity put		Liquidity put	
Traditional Bank					
FED backstop		Assets	Liabilities	Denosit	Incurance
TED BUCKST		Loans Reserves	Deposits Capital <	Deposit Insurance backstop	
		quidity put			

# Business of Capital funding ("SHADOW") Bank

Capital Funding Bank Global Money Dealer Asset Manager

Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
MBS SAD SAD SAD SAD SAD SAD SAD SAD SAD SA	MM funding	MM funding Liquidity reserves	"deposits" Capital reserves	"deposits"	Capital CDS   and an annual control co

#### **Derivative Dealer**

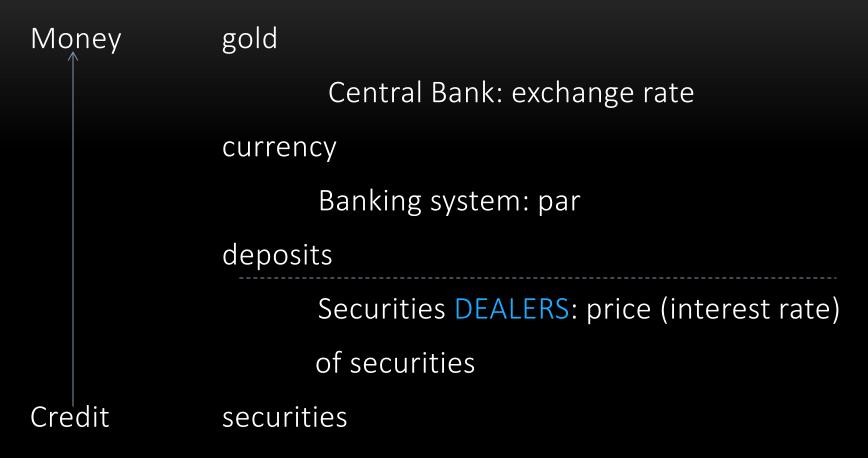
Assets	Liabilities		
CDS	CDS		
IRS	IRS		
FXS	FXS		
Liquidity reserves	Capital reserves		

Insurance: CDS: Credit Default Swaps IRS: Interest Rate Swaps FXS: FX Swaps

# Thinking on "SHADOW BANKING" Regulation

- Key players in market-based credit system are dealers, not capital funding (shadow banks) per se
- Key back stop for matched book dealers is liquidity, not capital
- Key backstop for speculative dealers is capital, not liquidity
- Survival constraint is about collateral flows, not just payment flows

# HIERARCHY of Financial Institutions: evolving



As Market based credit rises - Dealers are becoming more important and the Central Bank evolves from Lender to Dealer of Last Resort

#### REFERENCES

- 1. Institute for new economic thinking.
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- 4. IMF working paper: "The (sizable) Role of Rehypothecation in the Shadow Banking System", July 2010.
- 5. European Commission Green Paper "Shadow Banking", 2012.03.19.
- 6. FSB: Global Shadow Banking Monitoring Report, 2013.11.14.