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THE LURE OF SHADOW BANKING

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ABSTRACT

Financial intermediaries conduct maturity, credit, and liquidity transformation without access to central bank liquidity or public sector credit guarantees. The "shadow" banking system played a major role in the financial crisis. The rise of shadow banking over the last three decades, helped by regulatory and legal changes that gave advantages to three main institutions of shadow banking: money-market mutual funds (MMMFs) to capture retail deposits from traditional banks, securitization to move assets of traditional banks off their balance sheets, and repurchase agreements ("repo") that facilitated the use of securitized bonds in financial transactions as a form of money. A central idea in the evolution of a bankruptcy "safe harbor" for repo has been a crucial feature in the growth and efficiency of shadow banking, and so regulators can use access to this safe harbor as the lever to enforce new rules. Examples of shadow banks include finance companies, asset-backed commercial paper (ABCP) conduits, limited-purpose finance companies, structured investment vehicles, credit hedge funds, money market mutual funds, securities lenders, and government-sponsored enterprises.

KEYWORDS: Shadow- Banking, MMMFs, Securitization, Repurchase Agreements ABCP.