



FEDERAL RESERVE BANK *of* NEW YORK

# Shadow Banking. Principles for forward looking monitoring

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Regulating Shadow Banking  
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The views expressed in this presentation are those of the author and do not necessarily represent those of the Federal Reserve Bank of New York or the Federal Reserve System



# Sources

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<http://www.newyorkfed.org/research/epr/12v18n2/1207peri.pdf>
- Cetorelli, Mandel and Mollineaux (2012) “The Evolution of Banks and Financial Intermediation: Framing the Analysis”  
<http://www.newyorkfed.org/research/epr/12v18n2/1207cet1.pdf>
- Adrian, Ashcraft and Cetorelli (2013) “Shadow Bank Monitoring”  
[http://www.newyorkfed.org/research/staff\\_reports/sr638.pdf](http://www.newyorkfed.org/research/staff_reports/sr638.pdf)
- Cetorelli, McAndrews and Traina (2014) “Evolution in Bank Complexity”

*“A gloriously life affirming film ...”*



*... and one of the best depictions of **banking** in Hollywood history as well!*



# Accurate description of traditional banking



- Deposit taking
- Loan making
- Short-term vs long-term liabilities
- A bank run
- Equity injection to confront the run
- ...

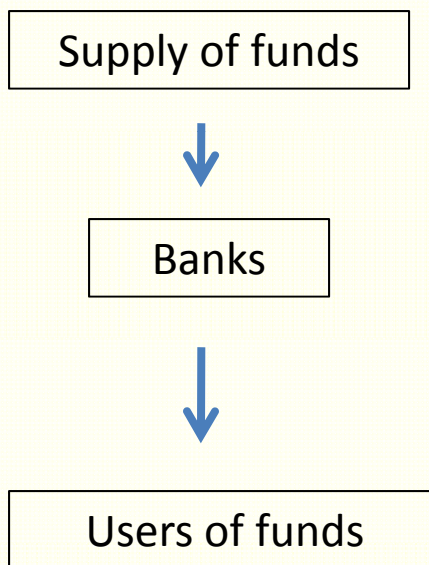
There is even a bank examiner ...





# Hard to do a modern remake

Traditional model. Banks are the main brokers in the process of credit intermediation



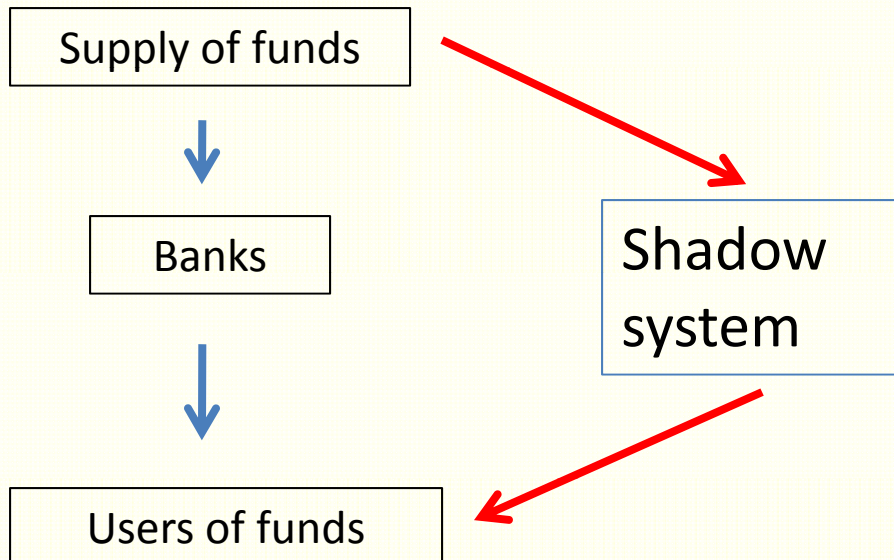
Roles played inside the bank:

- Specialized lending
- Fund management
- Guarantor
- Underwriting
- Broker/Dealer

...

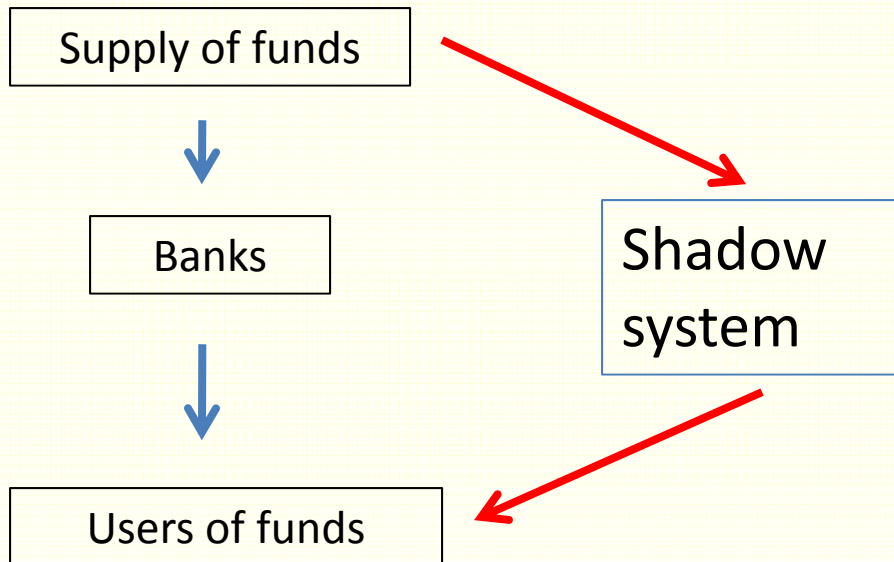
Intermediation activity on banks' balance sheet

# New model of intermediation



- Change in technology of intermediation
- Asset securitization breaks the link between deposit taking and loan making

# New model of intermediation



- Intermediation services provided separately over longer intermediation chain.
- Specialized providers emerge, their interactions mediated through markets



# Deriving definition of shadow banking

- Credit intermediation activity done outside regulated banks
  - Still a combination of “traditional” banking functions: maturity transformation, liquidity transformation and credit transformation

This definition consistent with Financial Stability Board approach

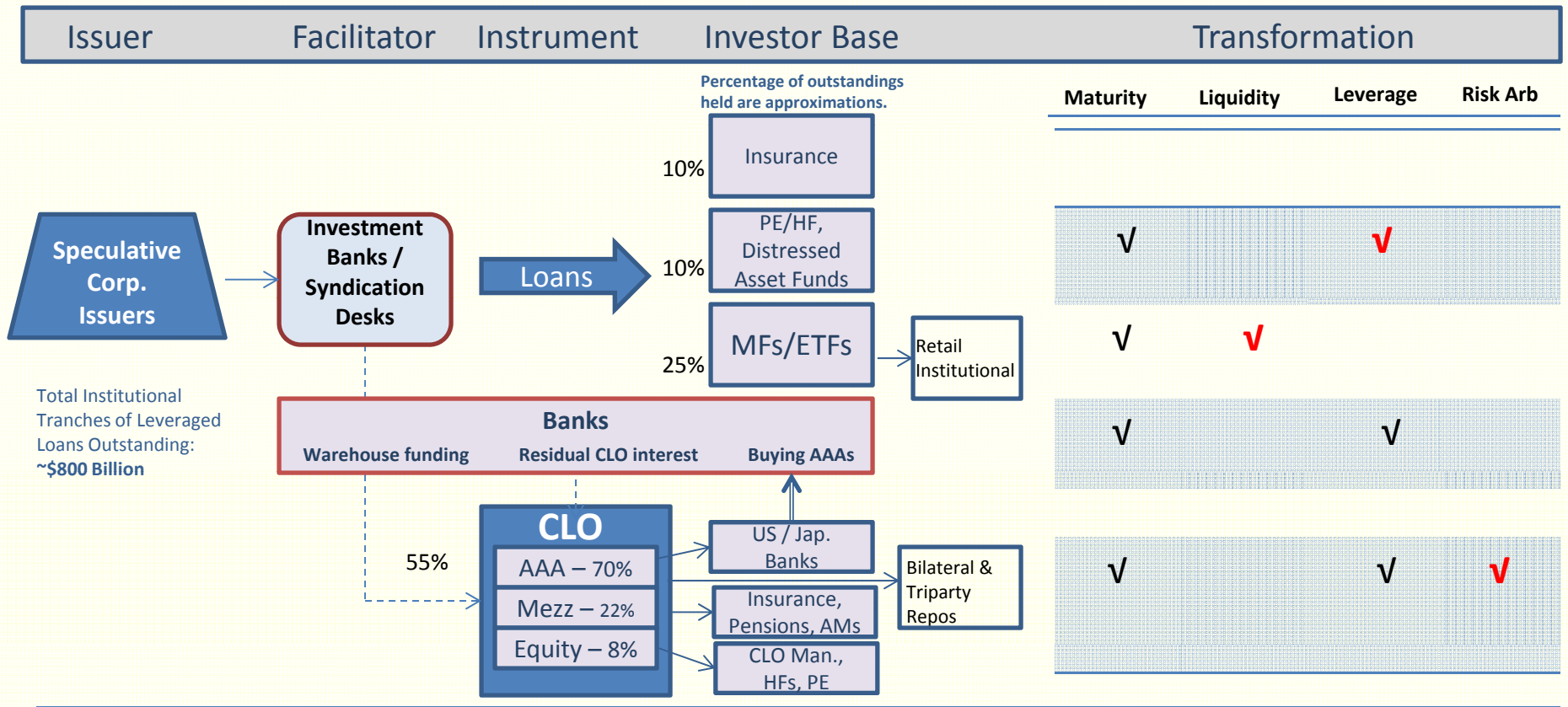
# Role of banks?

- Direct participants on the “chain”
- Guarantors to shadow banks. “Private” central bankers to shadow banking system
- Organizational channel. Acquisition of shadow bank entities. Expansion of “boundaries” of the banking firm.



# Institutional Leveraged Loan Markets

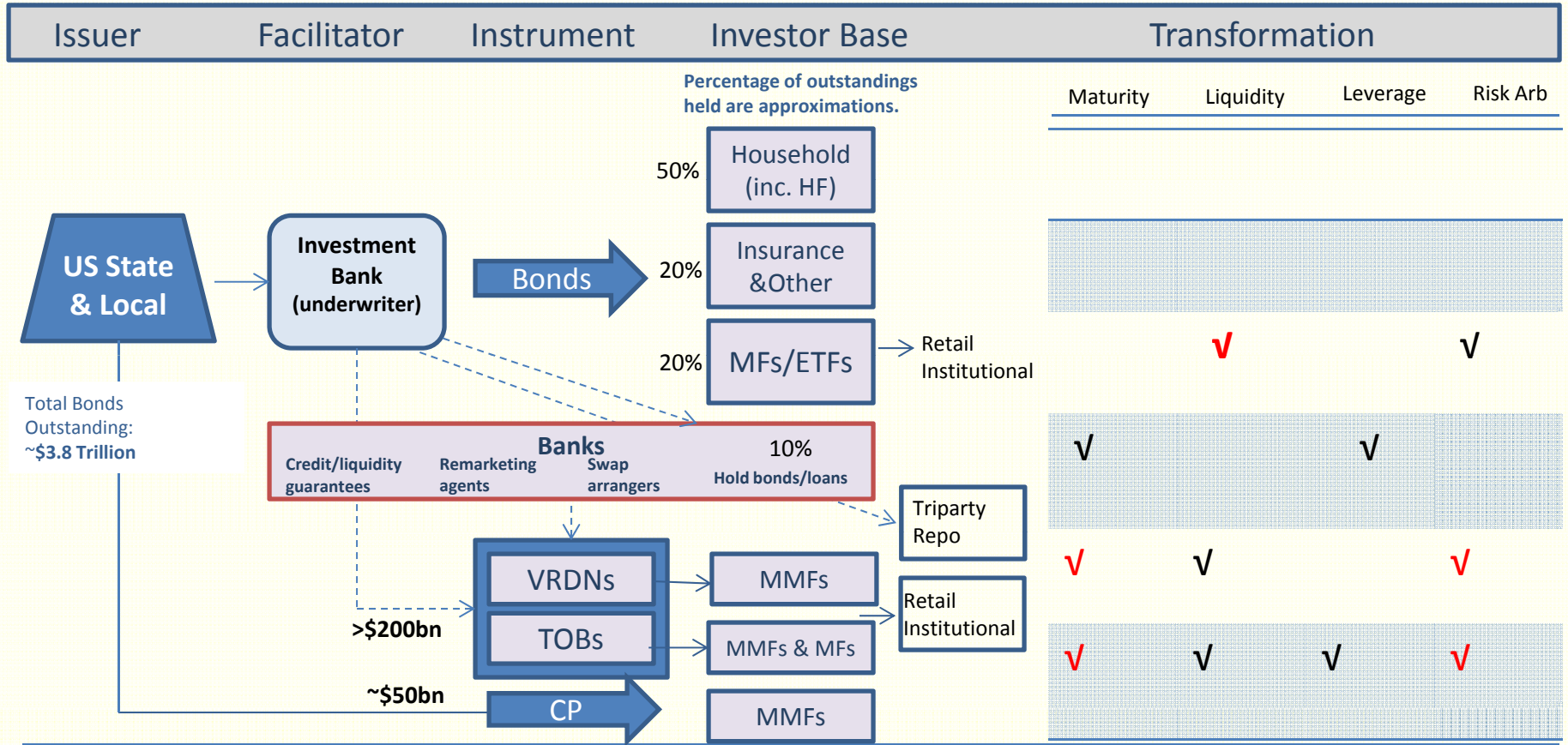
## *Shadow Intermediation Chain*



Source: Robert Patalano, Markets Group, NY Fed

# Municipal Markets

## Shadow Intermediation Chain



Source: Robert Patalano, Markets Group, NY Fed



# Organizational channel

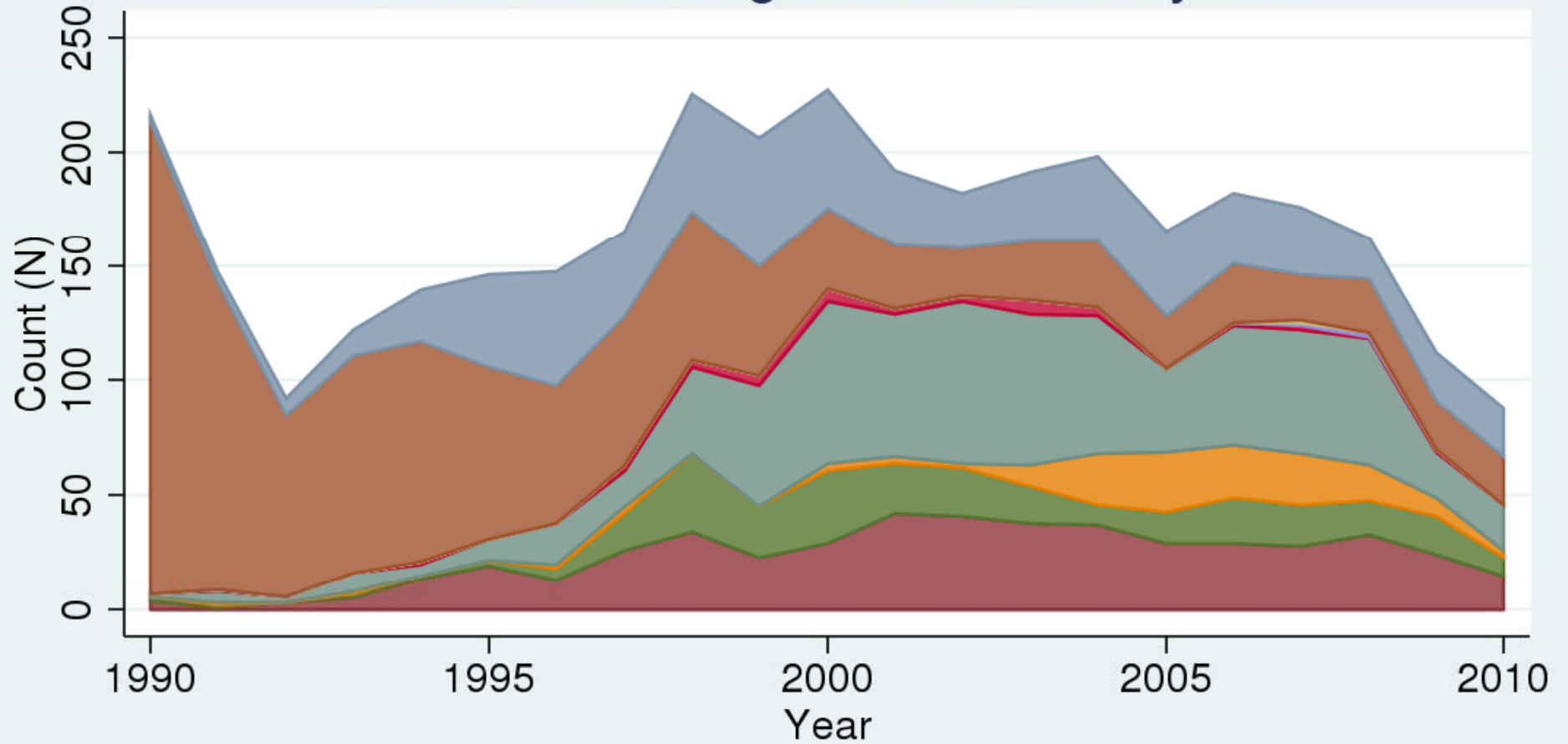
- In shadow intermediation, decentralization of intermediation activities. Some traditional frictions are resolved, but other frictions are created (e.g. Ashcraft and Schuerman, 2008)
- Folding specialists under common ownership and control internalizes frictions.
- BHC expansion is an efficient solution to modern intermediation frictions

# Facts on organizational adaptation of BHCs

- Substantial and widespread expansion into nonbank industries via acquisition over the last 30 years
- Examples: banks buyers in 40 percent of all asset manager acquisitions, 26 percent of broker dealers, 37 percent of specialty lenders
- Banks change their organizational form from *generalist intermediaries* to *conglomerated specialists*



# Non-Bank Targets of Bank Buyers



## Relevance for forward looking monitoring

- When looked closely, modern financial intermediation seems less “shadowy” than we thought
- Regulated bank entities have kept a considerable footprint in modern financial intermediation.



# Relevance for forward looking monitoring

“Shadow begins at your own feet ...”

- Banks offer window into shadow intermediation and its continuous evolution
- Monitoring banks as a tool for effective forward looking monitoring of whole system