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BLOG

Shadow banking takes new shapes

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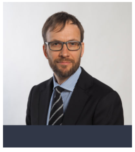

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Shadow banking is a broad concept. A possible definition is that it comprises non-bank institutions which undertake bank-like activities. Another characteristic, which the word 'shadow' refers to, is that the sector is overall less regulated.

Shadow banks can increase competition and spur innovation in the financial sector. The benefits could come in the form of improving efficiency and quality of financial services, and of offering better returns and risk diversification opportunities, especially for institutional investors. Shadow banks could also be beneficial to market liquidity.

On the downside, opacity and risks may increase in the financial markets. The lack of regulation implies that it is difficult to monitor and prevent the build-up of leverage and concentrated risks in the shadow banking sector. Hence, the sector can be a source of systemic risks.

Traditional banks may utilize the shadow banking sector for alleviating the effects of regulation, such as capital requirements. This is why shadow banks played a significant role in the build-up of the global financial crisis. Not all actual risks appeared on banks' own balance sheets. They were in effect hidden as off-balance-sheet items in shadow banks.

Although significant regulation of shadow banks has not been introduced, traditional banks' links with the shadow banking sector are regulated now more effectively.

This should help transform shadow banking into 'resilient market-based finance'.[1] The sector should stand on its own, and not transmit excessive risks to the banking sector via either direct financial links or the market price impact of fire sales of assets in a crisis situation.

Nonetheless, new regulatory loopholes between banks and non-banks may develop. Or risks may pile up in the shadow banking sector now that banks are more effectively regulated. Some researchers have therefore argued that regulation could also be extended to the shadow banking sector.[2]

1. See Mark Carney (2017): What a difference a decade makes. Bank of England speech.

An important part of the current growth in shadow banking comes from FinTech: the provision of financial services, which make use of technological innovations. Will these new digital technologies help in finding solutions to the traditional financing frictions? Or are we experiencing another boom in novel-looking financial services which ultimately bring about similar – or even additional - risks as traditional banking?

These and many other related topics will be discussed in the conference on Shadow banking: Financial intermediation beyond banks, organized by SUERF and Bank of Finland in the House of the Estates in Helsinki on 14–15 September 2017; see http://www.suerf.org/shadowbanking2017.

Tags

- banks
- economic growth
- financial markets
- FinTech
- shadow banking

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2. Samuel G. Hanson, Anil K Kashyap, Jeremy C. Stein (2011): A Macroprudential Approach to Financial Regulation, Journal of Economic Perspectives 25: 1, pages 3–28.