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Shadow Banking, Financing Markets and Financial Stability Speech by Paul Tucker

In a speech in London today, Paul Tucker - Deputy Governor for Financial Stability and a member of the Monetary Policy Committee - discusses one aspect of the financial sector 'structure' debate: the role of shadow banking. Shadow banking can be thought of as the collection of instruments, structures, firms or markets which, alone or in combination, and to a greater or lesser extent, replicate the core features of commercial banks: liquidity services, maturity mismatch and leverage. They are often considered a product of 'regulatory arbitrage' and can be problematic if the resulting non-bank forms of financial intermediation replicate the systemic risks posed by banking itself.

Paul Tucker discusses a number of examples that developed prior to the recent financial crisis. Those include: money market mutual funds; finance companies; Structured Investment Vehicles and Asset Backed Commercial Paper; the prime brokerage services of securities dealers; the use of securities lending as a financing market; and the repo-financing of mortgage-backed securities.

Overall, Paul Tucker emphasises the need to think through what might comprise shadow banking and how the regulatory system should respond. He says: "The primary task of the 'regulation and structure' debate is to make the core banking system safe and sound. In addition, we need to think through how to avoid the problems of the past few years replicating themselves beyond the perimeter of the regulated banking sector." And where shadow banking provides an alternative home for liquid savings, offering de facto deposit and monetary services, he argues that the authorities should be ready to bring them into the banking world itself. In the latest episode, constant-Net Asset Value, instant-access money funds and the prime brokerage units of the dealers seem to have been examples of that. Paul Tucker concludes by saying: "We have not seen the last of regulatory arbitrage. So we need policies and principles that stand in the way of its weakening the resilience of the system, while allowing enterprise and our capital markets to flourish."

Key Resources

Shadow Banking, Financing Markets and Financial Stability – Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech420.pdf>