The Vulnerabilities of Debt in the Shadow Banking Sector

Ross Spence | Berlin 29 October 2019
Agenda

• What is Shadow Banking?
• The Role of Debt
• Shadow Banking: Repos
• Financial Stability: Vulnerabilities of Debt
• Recommendations
What is Shadow Banking?
Debt

• What is Debt?
  - Prudentially Regulated Banking Sector
Shadow Banking: Repos

• Working Example:

*Opening Leg of the Transaction:*

A → B

€100 securities as FC

Gives €90 cash
(€100 - margin)

*Closing Leg of the Transaction:*

A → B

Repays €91 cash
(€90 + €1 Interest)

Financial Collateral €100
Traditional Banking vs Shadow Banking

**Traditional Banking Sector (Demand Deposit)**
- Depositor
- Bank
- Cash
- EDGS Insurance

**Shadow Banking Sector (Repo)**
- Buyer
- Seller
- Cash
- Financial Collateral
Financial Stability: Vulnerabilities of Debt

• Leverage
  - High debt levels
  - Margin/Haircut limits leverage
  - Marketable securities

• Rehypothecation/Re-use Risk

• Leverage and Liquidity Spiral
  - Financial collateral
  - Margin/haircuts
  - Liquidity
  - De-leverage
Recommendations

1. The Need for More Granular Data

2. Re-use/Rehypothecation Should be Limited

3. The Need for Minimum Margin/Haircut Regulation
Thanks for Listening!

Questions?