Abstract

There are several proposed definitions of shadow banking. Most definitions allude to:

1. Bank-like activities that are conducted outside the traditional commercial banking system.
2. Unregulated or lightly regulated financial activities.
3. Financial intermediaries that conduct maturity, credit and liquidity transformation without explicit access to central bank liquidity or public sector guarantees.
4. Regulatory arbitrage.

The shadow banking system take funds from savers and investors and ultimately provide them to borrowers. Shadow banking activities are conducted by investment banks, finance companies, money market funds, hedge funds, special purpose entities and other vehicles that aggregate and hold financial assets. These entities are critical players in the markets for securities, structured products, commercial paper, asset-backed commercial paper, repurchase agreements and derivatives. These activities finance substantial economic activity.

Shadow banks helped cause the financial crisis. Better regulated, they could help avert the next one. The Economist (May 10th 2014).