

Summary

This chapter describes the growth and risks of and regulatory responses to shadow banking—financial intermediaries or activities involved in credit intermediation outside the regular banking system, and therefore lacking a formal safety net.

The largest shadow banking systems are found in advanced economies, where more narrowly defined shadow banking measures indicate stagnation, while broader measures (which include investment funds) generally show continued growth since the global financial crisis. In emerging market economies, the growth of shadow banking has been strong, outpacing that of the traditional banking system.

Although shadow banking takes vastly different forms across and within countries, some of the key drivers behind its growth are common to all: a tightening of banking regulation and ample liquidity conditions, as well as demand from institutional investors, tend to foster nonbanking activities. The current financial environment in advanced economies remains conducive to further growth in shadow banking. Many indications there point to the migration of some activities—such as lending to firms—from traditional banks to the nonbank sector.

Shadow banking can play a beneficial role as a complement to traditional banking by expanding access to credit or by supporting market liquidity, maturity transformation, and risk sharing. It often, however, comes with bank-like risks, as seen during the 2007–08 global financial crisis. Although data limitations prevent a comprehensive assessment, the U.S. shadow banking system appears to contribute most to domestic systemic risk; its contribution is much less pronounced in the euro area and the United Kingdom.

The challenge for policymakers is to maximize the benefits of shadow banking while minimizing systemic risks. This chapter encourages policymakers to address the continued expansion of finance outside the regulatory perimeter through a more encompassing approach to regulation and supervision that focuses both on activities and on entities and places greater emphasis on systemic risk. To begin with, however, important data gaps need to be addressed because even aggregate information about many activities remains scarce in most countries.

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