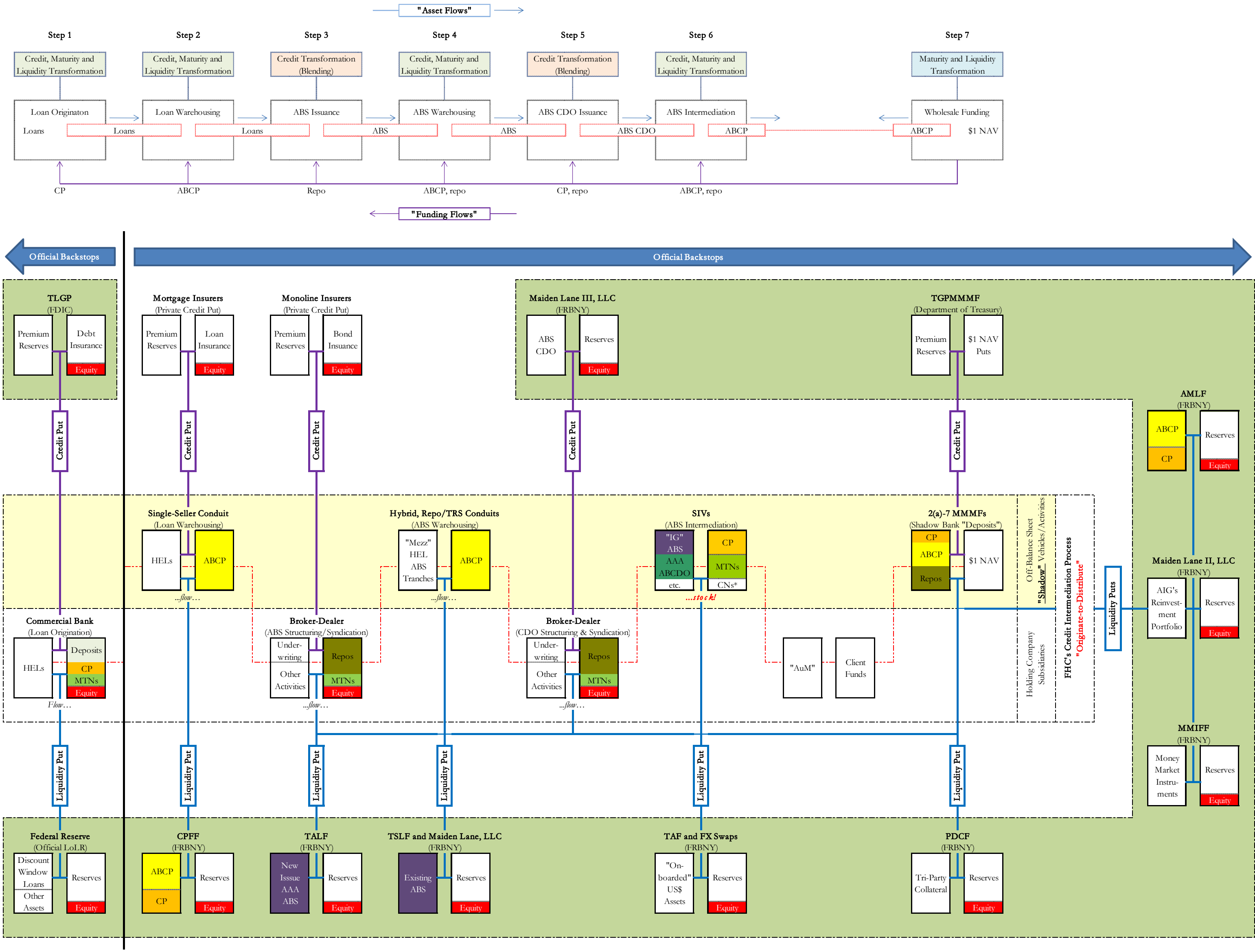
Appendix 8: The Post-Crisis Backstop of the Shadow Banking System

Once private sector credit and liquidity put providers' ability to make good on their "promised" puts came into question, a run began on the shadow banking system. Central banks generally ignored the impairment of such important pillars of the shadow banking system as mortgage insurers or monoline insurers. Once the crisis gathered momentum, however, central banks became more engaged. The series of 13(3) liquidity facilities implemented by the Federal Reserve amd the guarantee schemes of other government agencies essentially amount to a 360º backstop of the shadow banking system. The 13(3) facilities can be interpreted as functional backstops of the shadow credit intermediation process. Thus, CPFF is a backstop of loan origination and warehousing; TALF is a backstop of ABS issuance; TSLF and Maiden Lane, LLC are backstops of the system's securities warehouses (broadly speaking); Maiden Lane III, LLC is a backstop of the credit puts sold by AIG-FP on ABS CDOs; TAF and FX swaps are backstops of and facilitated the orderly "on-boarding" of formerly off-balance sheet ABS intermediaries (many of them run by European banks who found it hard to swap FX for dollars); and finally, on the funding side, PDCF is a backstop of the tri-party repo system (a "platofrm" where MMMFs (and other funds) fund broker-dealers and large hedge-funds) and the AMLF, MMIFF and Maiden Lane II, LLC are backstops of various forms of regulated and undregulated money market intermediaries. Furthermore, the Treasury Department's Temporary Guarantee Program of MMMFs was an additional form of backstop for money market intermediaries. This program, together with the FDIC's TLGP can be considered moder-day equivalents of deposit insurance. Only a few types of entities were not backstopped by the crisis, and some attempts to fix problems might have exacerbated the crisis. Examples include not backstopping the monolines early on in the crisis (this might have tamed the destructiveness of deleveraging) and the failed M-LEC which ultimately led to a demarcation line between bank-affiliated and standalone ABS intermediaries (such as LPFCs or credit hedge funds) as recipients and non-recipients of official liquidity. These entities failed too early on in the crisis to benefit from the liquidity facilities rolled out in the wake of the bankruptcy of Lehman Brothers, and their demise may well have accelerated and deepened the crisis, while also necessitating the creation of TALF to offset the shrinkage in balance sheet capacity for ABS from their demise.



Source: Shadow Banking (Pozsar, Adrian, Ashcraft, Boesky (2010))