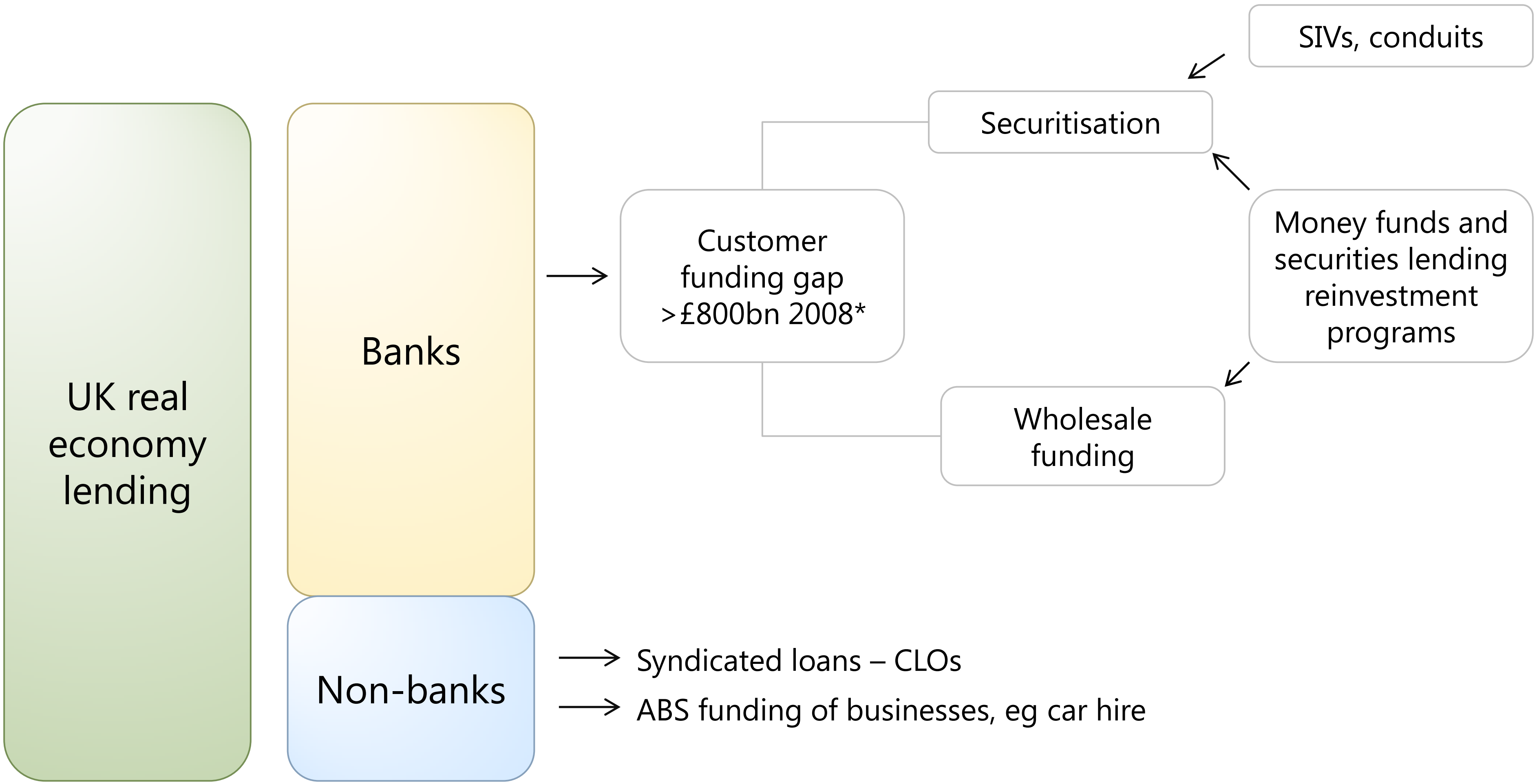
Shadow banking in the UK

Marnoch Aston – Ruffer LLP

Topics

- Shadow banking and the UK pre-crisis
  - Supporting UK real economy lending
  - Shadow banking activity
- Collateral upgrade trades – how they are metamorphosing
- Non-bank lending to the SME sector

Shadow banking supporting UK real economy lending



** Source: Bank of England Financial Stability Report, June 2009*

Pre-crisis UK based shadow banking activity

- UK banks were also big owner/operators of shadow banks
- SIVs, CDOs, CLOs, money and credit hedge funds were all run from London
- Investment banking
  - Rehypothecation of hedge fund assets
  - Credit repo
  - Structured products and asymmetric margining

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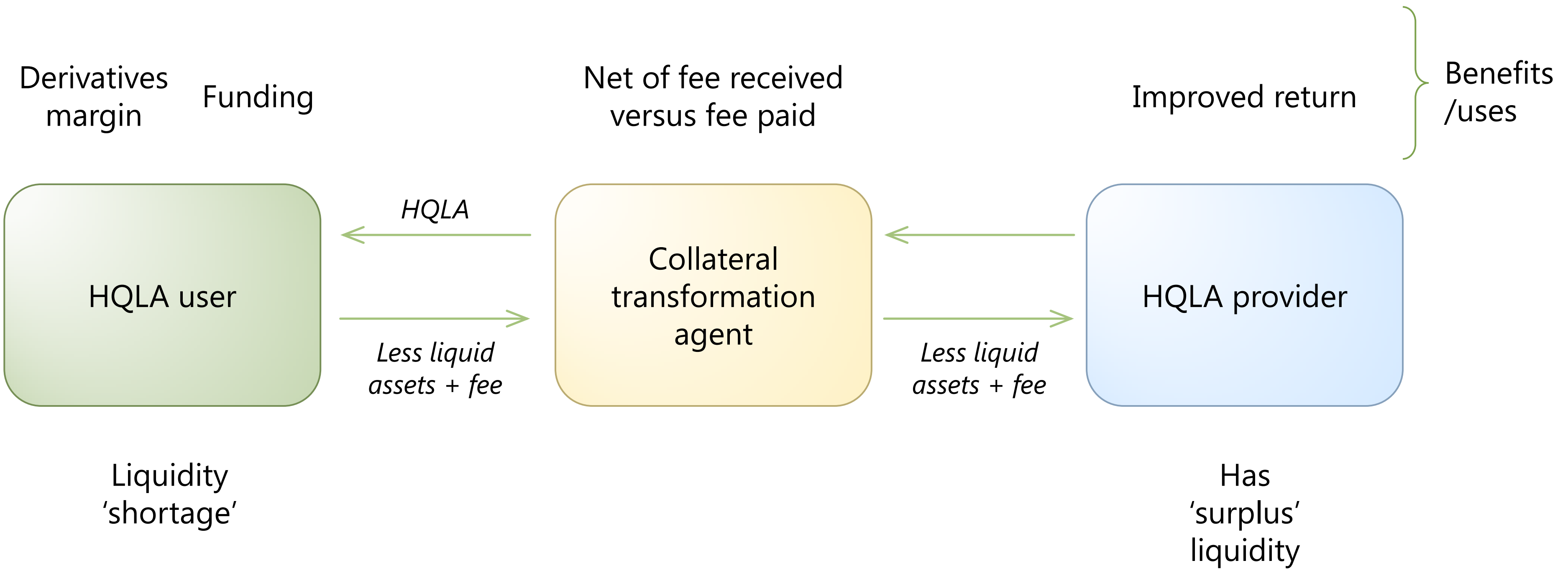
Collateral upgrade trades, a win-win?



Metamorphosis, increasing risks

Derivatives margin

Funding

LCR requirements

HQLA user

Collateral transformation agent

HQLA

Less liquid assets + fee

Newly created HQLA providers

- Structured products
- Synthetic ETFs
- Client services
  - asset manager using TRS
  - 'optimisation' of collateral

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Why can banks be dis-intermediated from SME lending

- Condition of banks
  - Important, but the Bank of England's Funding for Lending Scheme should have increased availability of funding
  - Regulation – biased against certain types of lending eg mezzanine

- The nature of SME lending

- Differing business models
  - The law of large numbers versus intensive credit work and structuring

Structures and risks

- Two main structures
  - Locked up funds
  - Private equity structures – reinvestment period followed by self liquidation
- Risks
  - Introduction of leverage
  - Introduction of maturity transformation

Summary

- Shadow banking was very important to the UK

- Collateral upgrade trades may pose increasing risks

- Non-bank SME lending is providing real benefits with very few of the risks posed pre crisis by shadow banks