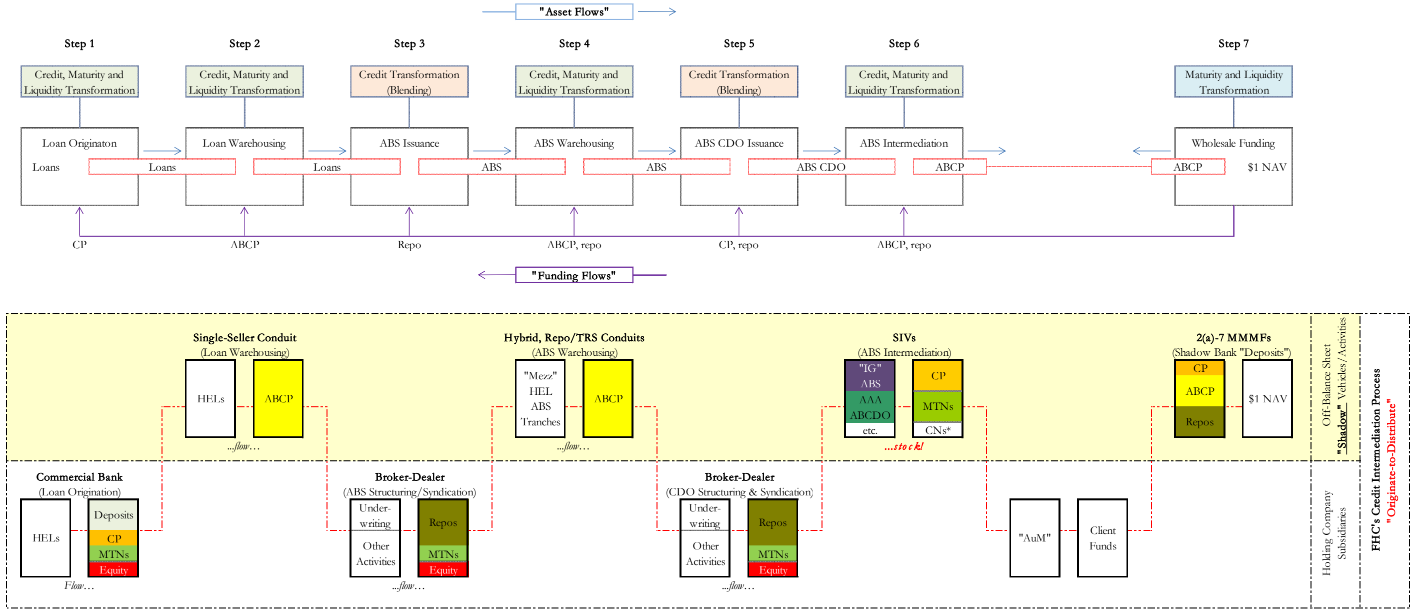
Appendix 2: The Credit Intermediation Process of Bank Holding Companies

The credit intermediation process of Financial Holding Companies flows through a chain of subsidiaries and off-balance sheet vehicles (shadow banks), and is funded in capital markets. This intermediation chain enhances the efficiency of bank equity for various reasons. If markets freeze and the FHC's subsidiaries have to "onboard" their normally off-balance sheet assets and activities, capital **efficiency** can quickly become capital **deficiency**, with systemic consequences. The process described here is an **originate-to-distribute** model of non-conforming mortgages, where the originating banks and the broker-dealers that slice and dice mortgages into ABS and ABS CDOS do not retain any first loss pieces along the intermediation chain.



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