FSB FINANCIAL STABILITY BOARD

# Call for papers

## Systemic risks and policies to address them in non-bank financial intermediation (NBFI)

## Public research conference on 8-9 June 2022

The financial market turmoil in March 2020, brought about by the COVID-19 shock, underscored the need to strengthen resilience in the non-bank financial intermediation (NBFI) sector. The Financial Stability Board (FSB) is coordinating the international regulatory community's assessment of identified vulnerabilities and the appropriate financial policy response, working closely with relevant standard setting bodies (SSBs).[1] This work involves:[2]

- assessing vulnerabilities in specific NBFI areas that may have contributed to the build-up of liquidity imbalances and the amplification of stress;
- enhancing the understanding and ongoing monitoring of systemic risks in NBFI; and
- developing policies to address such risks where appropriate, including by assessing the adequacy of current policy tools and approaches given the desired level of resilience for the sector.

This conference will contribute to the FSB's work to develop a systemic approach to NBFI. It will feature presentations of analytical work and research that advances the understanding of systemic risks in NBFI and specific policies and approaches that may be used to address them.

## Topics

Topic of interest for the FSB and SSBs include:

- How to measure interconnectedness (and the potential for the propagation of market stress) within the NBFI sector as well as with banks and the real economy;

- The drivers of liquidity imbalances in bond markets (demand and supply sides) and their implications for systemic risk;

- Data and analytical tools to enhance NBFI risk assessment and monitoring, including tools to analyse the behaviour of complex systems (e.g. network theory);

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[1] These include the Basel Committee on Banking Supervision (BCBS), the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

[2] See the FSB's *Enhancing the Resilience of Non-Bank Financial Intermediation: Progress report* (November 2021).

- The effects and policy implications of the extraordinary interventions by central banks and other authorities to stabilise financial markets during the March 2020 turmoil; and
- Policy tools and approaches that can be used by non-bank financial institutions and regulatory authorities to address systemic risk.

## Submission of papers

The deadline for submission is **31 March 2022**. Draft papers should be sent to NBFI.Conference@fsb.org. Authors of accepted papers will be notified by **late-April 2022**. Depending on COVID-19 developments, the conference may be held in a hybrid format, with some physical attendance in Basel. In such a case, the organisers will reimburse travel and accommodation expenses for speakers with accepted papers who would like to come to Basel for this conference. If a hybrid format is not feasible, the conference will be held virtually.

## About the FSB

The FSB coordinates at the international level the work of national financial authorities and international standard-setting bodies and develops and promotes the implementation of effective regulatory, supervisory, and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with approximately 70 other jurisdictions through its six Regional Consultative Groups.

The FSB is chaired by Klaas Knot, President of De Nederlandsche Bank. The FSB Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

## Background

Resilience refers to the capacity of the NBFI sector, and the financial system at large, to absorb shocks of different types.[3] In contrast to the 2008 financial crisis, the COVID-19 shock originated outside the financial system. Irrespective of the source of the shock, the global financial system should be able to withstand it and continue to supply financial services to support the real economy. Enhanced resilience does not rule out the possibility of jurisdictions' public interventions if the shock is extreme and leads to disruptions in the provision of financial services that are severe enough to adversely impact the real economy. But such interventions should take place in extraordinary situations rather than becoming embedded in expectations of market participants, as this would lead to moral hazard and distort markets.

Conjunctural factors and structural changes in the global financial system over the past decade have increased the reliance on market-based intermediation. NBFI has grown considerably – to almost half of global financial assets, compared to 42% in 2008 – and become more diverse over this period.[4] As a result, the importance of NBFI for the real economy has increased and is likely to continue to grow. Underlying drivers for this growth include long-term demographic trends leading to asset accumulation; macro-financial factors such as accommodative monetary policies; rising valuations; and post-2008 crisis reforms, which have increased the relative cost of bank-based finance.

The growth of NBFI implies that risks are increasingly being intermediated and held outside the banking sector, with implications for global financial system resilience. A shift from the traditional model where banks keep credit risk on their balance sheets to a model where it is borne by end-investors, and traded in financial markets, means that financial resilience tends to depend less directly on bank buffers and more on the ability of investors to effectively manage market, credit and liquidity risk in times of stress. This in turn implies greater reliance on market liquidity and price signals for managing portfolios and the associated risks.

Resilient market-based intermediation depends on the ability of market participants to manage risks efficiently and minimise market dislocations when adjusting their portfolios. These dislocations become more likely in the case of large imbalances between liquidity supply and demand. The interaction of a shock with existing vulnerabilities – including liquidity and maturity mismatches, as well as high leverage – may lead to sudden and large shifts in the demand for, and supply of, liquidity. Liquidity demand may increase as market participants seek to increase cash holdings while at the same time liquidity supply may decline due to deleveraging and reduction of market making services. If the resulting liquidity imbalances become sufficiently pervasive, deteriorating liquidity conditions may create risks to financial stability.

Changes to the financial system over the past decade have resulted in shifts to both the demand and supply of liquidity, as well as changes to their sensitivity in a given shock. On the one hand, the demand for liquidity has increased as the size of debt markets and the importance of investors (such as funds) offering liquidity on demand has grown. This growth may have been sustained by the low interest rate environment and other factors (e.g. tax

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3 For a discussion of the relationship between resilience and financial stability, see the FSB *Financial Stability Surveillance Framework* (September 2021).

4 See the FSB's *Global Monitoring Report on Non-Bank Financial Intermediation 2021* (December 2021).

treatment) that have encouraged debt accumulation and a search for yield by investors. On the other hand, the supply of market liquidity by banks – which continue to play a critical role in core funding markets – has not kept pace with this increase. The combination of these factors implies potentially larger swings in liquidity needs for a shock of a given size. In addition, greater interconnectedness among market participants has accentuated market stress through different parts of the system.

The March 2020 market turmoil has underscored the need to strengthen NBFI resilience, by providing a real-world example of how vulnerabilities related to particular non-bank activities and entities can interact. An extremely high demand for liquidity during the 'dash for cash' resulted in the broad-based selling of financial assets and to sizeable redemptions from investment funds, margin calls resulting from increased volatility, and unwinding of positions by some non-bank leveraged investors.[5] Key funding markets experienced acute stress and public authorities needed to take a wide range of measures to restore market functioning.

The FSB is coordinating work to enhance the resilience of the NBFI sector while preserving its benefits. Its NBFI work programme builds on the lessons from the March market turmoil and includes analytical and policy work to examine and, where appropriate, address specific issues that contributed to amplification of the shock; enhancing understanding and strengthening the monitoring of systemic risks in NBFI; and assessing policies to address systemic risks in NBFI. Enhancing NBFI resilience is intended to ensure a more stable provision of financing to the economy and reduce the need for extraordinary central bank interventions. These efforts should not compromise the resilience in other parts of the system or the important role that NBFI plays in financing the real economy.

Understanding systemic risks in NBFI involves analysis of the interaction and propagation of risks from a system-wide perspective. Conceptually, such a system-wide perspective would combine the following layers: (i) an assessment of potential vulnerabilities and the resulting liquidity demands under stress across different non-bank financial institutions and markets; (ii) the identification and quantification, to the extent possible, of key interconnections that could propagate market stress across the global financial system; and (iii) an assessment of the potential interaction of vulnerabilities and interconnections, and their implications for the liquidity of core markets that underpin the functioning of the global financial system.

Policies to address systemic risk in NBFI will have to take into account the heterogeneity of the sector. The focus of policy work is to ensure that the toolkit is adequate and effective from a system-wide perspective, drawing on the lessons from the March 2020 market turmoil. Types of policies that could be considered include measures to: mitigate unexpected and significant shifts in liquidity demand; enhance the resilience of liquidity supply in stress; and enhance risk monitoring and preparedness of authorities and market participants. International cooperation and coordination on policies is necessary given the cross-border nature of NBFI.

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[5] See the FSB's *Holistic Review of the March Market Turmoil* (November 2020).