John Schindler

Secretary General - Financial Stability Board

Building bridges: the case for better data and coordination for the non-bank sector

The views expressed in these remarks are those of the speaker in his role as FSB Secretary General and do not necessarily reflect those of the FSB or its members.

Thank you for having me here today. This is my first visit to Eurofi and my first trip to Budapest. I want to speak to you today about a topic of increasing importance to financial authorities on both sides of the Atlantic, and indeed around the world: Non-Bank Financial Intermediation (or NBFI or what I will call the non-bank sector).

The 2008 global financial crisis exposed severe vulnerabilities in the global financial system, and it prompted an awareness that we needed to be more vigilant to financial stability considerations.

The global financial regulatory community embarked on an ambitious reform agenda, scrutinising the entire financial system — banks and non-banks alike — to build resilience. In the banking sector, Basel III was developed to enhance capital requirements and liquidity management and to reduce leverage. A parallel focus was placed on what was then commonly referred to as 'shadow banking', but that focus matured into a holistic approach to what we now refer to as non-bank financial intermediation.

Fifteen years later, we face a different financial system. The system has evolved because of our regulatory interventions, innovation, and shifts in global economic and financial conditions. One of the most notable changes has been the increasing importance of the non-bank sector.

Today, I want to make three points as I focus on this critical part of our financial system:

First, the non-bank sector is increasingly critical to the global financial system, and that criticality has been highlighted by the role the sector has played in recent periods of market turmoil.

Second, calling it the non-bank sector may have been appropriate for a while, but the time has come to stop referring to it as if it is monolithic.

And finally, we need more and better data from this critical area.

The non-bank sector is increasingly critical to the global financial system

The non-bank sector has grown in size, complexity, and importance since the GFC, with global assets reaching approximately $220 trillion in 2022. But the core issue, which can't be encapsulated in any single number, is where risk is building up within the financial system. Over the last decade, again and again, we see parts of the non-bank sector playing a central role in amplifying shocks across the financial system during periods of stress.

The changing role of the non-bank sector has been driven by several factors.

First, regulatory shifts. Stricter regulations on banks have led to the migration of certain activities to the non-bank sector. For example, non-bank lenders and other entities now play a more prominent role in credit intermediation and in critical activities such as the provision of market liquidity.

Second, the search for yield. The prolonged low-interest-rate environment that followed the Global Financial Crisis drove investors to seek higher returns in alternative asset classes, to seek larger maturity and liquidity mismatches, and to use more leverage.

Finally, technological innovation. The rise of fintech and online lending platforms has introduced new forms of financial intermediation, often operating outside the traditional regulatory framework.

While this has brought benefits, including increased access to credit, it has also introduced new kinds of risk. In recent years, we have witnessed several episodes of market turmoil in which the non-bank sector played a significant role.

The onset of the COVID-19 pandemic was a sharp and sudden shock to global financial markets. Investment funds and money market funds, faced significant liquidity pressures, as investors sought to redeem their holdings amid the heightened uncertainty.[1]

In the commodity market turmoil following the Russian invasion of Ukraine, commodity prices and volatility spiked. Non-bank entities, especially commodity trading firms and some investment funds, experienced substantial stress. Weak liquidity management practices and interconnectedness led to contagion.[2]

Those two examples followed external, nonfinancial shocks. The implosion of FTX and the collapse of Archegos did not. Those two events were stark reminders of the risks associated with leverage and concentrated exposures within the non-bank sector. Archegos, in particular, led to significant losses for investors and counterparties, and raised concerns about the adequacy of risk management practices among prime brokers.

Finally, there was the turmoil in the UK gilt market. A sharp rise in gilt yields led to severe liquidity challenges because of the investment strategies of some pension funds. The liquidity issues led to contagion that necessitated central bank intervention.

These examples highlight the importance and the interconnectedness of the non-bank sector and the existence of vulnerabilities in the sector that can spread to the broader financial system.

Historically, the regulation of the non-bank sector has focused more on investor protection or market integrity or other similar mandates. However, these mandates do not fully capture the systemic nature of risks that the sector can pose to the global financial system. The negative externalities that can arise from non-bank activities during times of stress suggest that a financial stability perspective is necessary. This perspective requires us to consider not just the risks to individual investors or markets, but also the potential for systemic risks – risks that can have far-reaching implications for the global financial system and the global economy.

The FSB has argued that we must adopt a financial stability perspective when regulating and supervising the non-bank sector. This is not a case of treating this sector differently or failing to acknowledge how important this sector is. Just the opposite. It is precisely because of how important this sector is to the functioning of the global financial system that we should bring and enhance the financial stability perspective to the regulation and supervision of this sector.

This also doesn't mean treating non-bank institutions and activities the same way as banks. The two sectors have different business models and risk profiles. Indeed, there are many business models in the non-bank sector.

Bringing a financial stability perspective to the non-bank sector means acknowledging the centrality of the non-bank sector to the proper functioning of the global financial system and the way the non-bank sector can amplify shocks to the financial system. Therefore, regulatory frameworks should be in place to mitigate the risks that non-bank institutions or activities can pose to financial stability.

For example, following the turmoil that surrounded the onset of the COVID pandemic, the FSB emphasised the need to enhance the resilience of non-banks to market stress by addressing mismatches in liquidity that can amplify crises. That has underpinned our work on money market funds and open-ended funds in recent years. Currently, the FSB is considering actions that might be useful to mitigate the risks of leverage in the non-bank sector and recommendations to ensure market participants are better prepared for margin and collateral calls.[3]

Dissecting the non-bank financial sector into its constituent parts

Turning to my second point on referring to this critical sector as the non-bank sector. For many years, NBFI has been referred to as if it were a monolithic entity. That approach was useful for a time as we tried to identify the broad contours of this vastly diverse set of institutions and activities. However, this approach is no longer sufficient. We have reached a point where broad studies of the non-bank sector are not as useful. We need to drill down into the gallimaufry of non-bank entities and activities.

The FSB has already started to do this, as I alluded to in some of my earlier examples. We have been looking at specific entities and activities where vulnerabilities are more pronounced and where these can create financial stability risks. We seek to understand the unique challenges associated with each and consider the possible interactions among these entities and activities, especially during stress. In our ongoing work on NBFI leverage, we first delved into non-bank leverage broadly, and then we started doing more in-depth work in specific areas where risks to financial stability may be more prominent. Going forward, this more targeted approach would suggest focusing on markets or entities that are known to be potential amplifiers of shocks.

By dissecting the non-bank financial sector into its constituent parts and looking at the behavior of those parts during stress, we can better identify potential threats to financial stability and develop policies that are appropriately calibrated to the specific risks involved.

We need more – and better – data on NBFI

This brings me to my final point: We need more and better data, particularly on those parts of the non-bank sector which are least regulated.

Over the past fifteen years, we have become much better at assessing vulnerabilities to the financial system as a whole and to the banking sector in particular. Our assessments have become more systematic – looking at things like the valuation of assets, use of leverage, maturity and liquidity mismatches, interconnectedness, and complexity. Making such assessments requires enormous amounts of data. In many cases, such data are publicly reported, or measures of vulnerabilities can be calculated from publicly reported data sources. In other cases, such assessments lean on supervisory data. Our ability to assess vulnerabilities and to develop policies to mitigate those vulnerabilities is only as good as the data we have.

There is a reason why the non-bank sector was formerly called "shadow banking". The sector has traditionally been characterised by a lack of transparency, meaning there are data gaps that hinder its effective oversight. Those gaps mean that often we can't identify vulnerabilities until periods of market stress reveal them, sometimes with painful consequences.

The FSB has had some success in improving the availability and quality of data for this sector. The FSB's Global Monitoring Report on NBFI provides insights into the size, composition, and main trends and risks in the sector. However, challenges remain related to data availability, quality, and use.

On availability, in some jurisdictions there are no legal requirements for some non-bank financial entities to report data that are critical for financial stability assessments. This creates gaps in our understanding of the sector's activities and exposures.

On quality, even when data are available, they may not be fit for the purpose of assessing financial stability risks. For example, data collected for investor protection or market conduct purposes may not capture the systemic risks associated with leverage, liquidity mismatches, or interconnectedness.

Finally, in some cases, data are collected but not used effectively or are not shared with those who need them for financial stability purposes. This can be due to legal or operational barriers that prevent data-sharing among regulators, both domestically and internationally.

The quality and timeliness of non-bank data is essential to the identification and assessment of vulnerabilities and to the design and calibration of effective policies. We must address these data challenges, because we cannot rely on periods of market stress to reveal vulnerabilities in the sector

Conclusion

The financial system is constantly evolving, and so too must our approach to safeguarding it. This requires a concerted effort to improve data collection, reporting, and sharing practices across the sector. It also requires greater cooperation and coordination among national and international regulators and with the non-bank sector.

Just as the Chain Bridge here in Budapest connects Buda and Pest, we have to bridge the gaps in data and cooperation that exist between the regulatory community and non-bank practitioners. By working together – across sectors, jurisdictions, and borders – we can ensure that the non-bank sector remains a source of strength, rather than vulnerability, for the global financial system.

Thank you.

1. See the FSB's Holistic Review of the March 2020 Market Turmoil.
2. The FSB report on The Financial Stability Aspects of Commodities Markets provides further detail.
3. See the FSB's latest progress report on its NBFI work programme for further details.