Growth of non-bank financial intermediaries, financial stability, and monetary policy

Discussion

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2025 ECB Forum on Central Banking
June 30th - July 2nd
Sintra, Portugal

Summary of the Paper

1. Growth of NBFIs
   - Commonality in overall trend between EA and US
   - Structural differences: EA more bank-centric
     - EA NBFIs relatively more *inside* banking firms (subsidiaries/affiliates in EA banking groups)
2. Financial Stability
   - Growth of NBFIs in EA can be an opportunity to develop markets and enhance resiliency/redundancies
   - But complexity may beget fragility
     - Structural challenges in EA – Market fragmentation; Outward oriented NBFIs; Uneven supervisory framework for NBFIs
3. Monetary Policy
   - Multiplication of transmission channels
   - NBFIs as potential vehicles to bridge gaps in fragmented EA, achieve smoother pass through
   - <u>Access to CB liquidity a necessary step?</u>

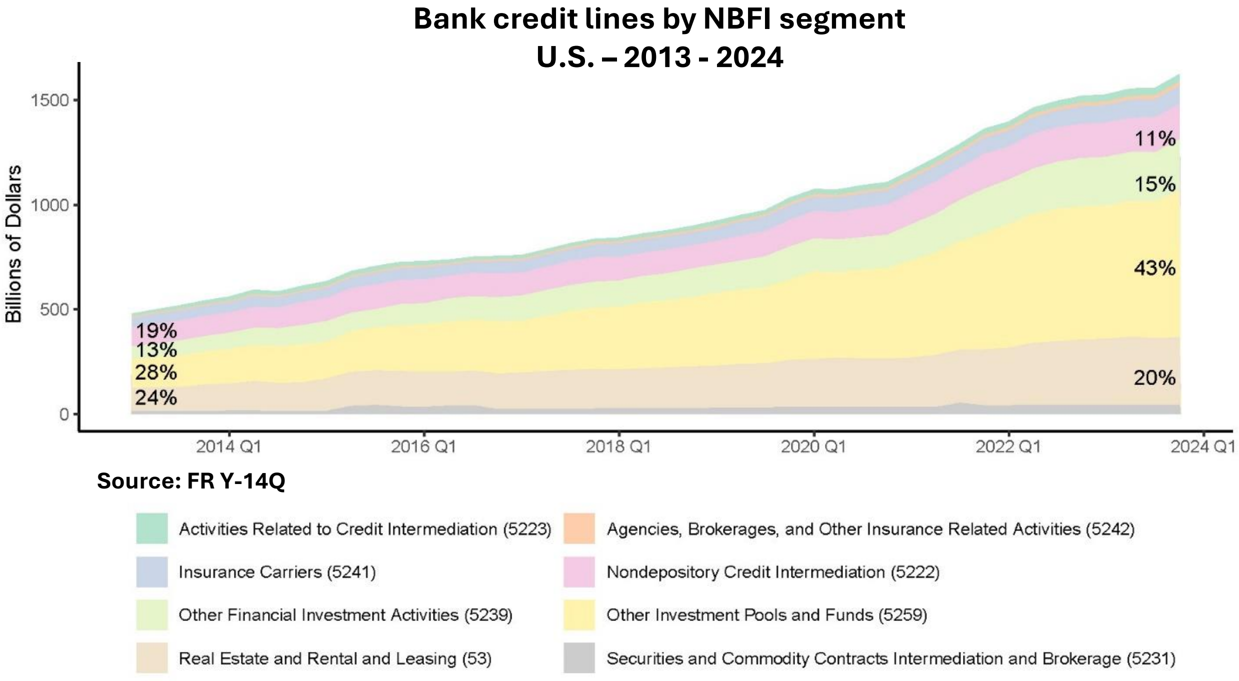
A Complementary Perspective

- Take a step back
- Why do Non-Bank Financial Intermediaries emerge?
- Are there common principles explaining NBFIs growth?
- Leverage such principles to develop a coherent, unified (and jurisdiction neutral) view to interpret growth of NBFIs, the financial stability implications and related monetary policy considerations

NBFIs Naturally Dependent on Banks

- Nonbanks engaging in *intermediation* activities – Maturity/Liquidity transformations
- Management of liquidity risk essential component of intermediation activities
- Intrinsic fragilities
- How do *banks* manage liquidity risk?
    - Access to stable deposit funding. Deposit insurance important factors behind stability
    - Access to CB liquidity
- NBFIs do not have standard access to liability guarantees, nor to liquidity facilities
- Banks the natural providers of liquidity to NBFIs

Strong evidence of role of banks supporting growth of NBFIs



Source: FR Y-14Q

- Growing bank exposures to NBFIs in EA as well
- Especially important growth of committed lines (EBA, 2024)

"*Where Do Banks End and NBFIs Begin?*" (2024), Acharya, Cetorelli and Tuckman

"*Transformation of Risks across Banks and NBFIs*" (2025) Acharya, Cetorelli and Tuckman

Revisit NBFI growth

- NBFI asset growth *per se* only telling a partial story
- Growth of NBFIs not necessarily implying a *substitution* of banks
- Rather, a *transformation* of the role banks play in intermediation ecosystem
- Hypothetical counterfactual : Absent bank support, NBFI growth much reduced

Revisit Financial Stability implications

- Underestimation of banks' true risk exposures
  - Banks may be less exposed to credit risk, but more exposed to liquidity risk
- Underappreciation of risk propagation and amplification mechanisms between banks and NBFIs
  - Banks themselves a vector of instability
  - Fire sale dynamics
- Pernicious externalities in a system increasingly less subject to prudential standards

Revisit Monetary Policy considerations

- Should NBFIs be granted access to CB liquidity?
  - Standard trade offs well understood
    - Boost NBFIs role in bridging fragmented EA markets
    - Design access to minimize moral hazard
- Conjecture: It may not be a stable equilibrium
  - Access to CB liquidity would break down NBFI dependence on banks
  - And reduce uniqueness/specialness of banks
  - Should lead (this time for real) to debasement of banks
  - Might then trigger "political economy" forces
    - Banks invoking leveling of playing field
    - A *race to the (regulatory) bottom*

An alternative approach

- Leverage the financial conglomerate model prevalent in EA!
- Provide conditions for the growth of NBFIs *inside* banking groups
- Best of both worlds?
    - Growth of specialist intermediaries that can support capital market development and reduction in market segmentation
    - *And* intermediaries subject to homogeneous prudential standards
- Liquidity needs internalized *within* the conglomerate, *across* bank and nonbank subsidiaries
    - <u>This was the prevalent model in the U.S. up to the GFC</u> (**"The Nonbank Footprint of Banks"**, 2025 Cetorelli and Prazad)
    - Intermediaries inside U.S. BHCs *less reliant* on CB liquidity in times of stress

Takeaways

- This is <u>NOT</u> a Ptolemaic view, with banks at the center of the intermediation universe
- Quite the contrary, recognizing banks are just one component of an increasingly complex ecosystem
- Banks and NBFIs in a symbiotic relationship
- Not a bug of the system but a structural feature – and jurisdiction neutral
- Key to develop insights into evolution of the system and related policy making