Financial system remains vulnerable to further liquidity strains, FSB warns

- The progress report presents findings of work to assess and address “key amplifiers” of liquidity stress in non-bank financial intermediation (NBFI).

- The report on the financial stability implications of NBFI leverage identifies pockets of high leverage in the NBFI sector and outlines the policy implications.

- The March 2020 market turmoil and subsequent events, including the failure of Archegos and strains in commodities and bond markets, underscore the need to enhance the resilience of the NBFI sector.

The Financial Stability Board (FSB) published today its annual progress report to the G20 on enhancing the resilience of non-bank financial intermediation (NBFI).

The report presents findings of analytical work on vulnerabilities in particular entities and activities that may contribute to aggregate liquidity imbalances. It also describes policies being developed by the FSB and standard-setting bodies (SSBs) to reduce excessive and potentially destabilising spikes in liquidity demand, focusing on structural liquidity mismatch in open-ended funds and on margining practices.

The report stresses the importance of ensuring that the various policies fit together from a system-wide perspective and warns that until these policies are finalised and fully implemented, the vulnerabilities evident in recent market incidents remain. The report outlines further work to assess and address systemic risk in NBFI that the FSB and SSBs will carry out.

A key area of policy focus in 2024 is addressing financial stability risks from NBFI leverage. Leverage is a financial mechanism used to increase exposure, boost returns or take positions that can offset potential losses from other exposures (hedging). Accompanying the annual progress report, the FSB also published today its report on the financial stability implications of leverage in non-bank financial intermediation. The report provides an overview of aggregate NBFI leverage trends across FSB jurisdictions and the vulnerabilities associated with that leverage. It concludes that there are pockets of high leverage in the NBFI sector, such as in hedge funds. The report identifies a number of data gaps that make it difficult to fully assess the vulnerabilities associated with NBFI leverage and outlines policy implications to address these vulnerabilities, including:
Addressing the most salient data gaps, by considering the use of trade repository data, enhancing reporting requirements for non-banks with high levels of leverage, and expanding disclosure requirements.

Containing excessive leverage behaviour, by carrying out further work on haircuts and margins for derivatives and securities financing transactions.

Mitigating the financial stability consequences of high NBFI leverage, including by considering measures to enhance prime brokers' risk management and improve the liquidity preparedness of non-bank investors.

The FSB, in cooperation with SSBs, is already working on some of these issues as part of its NBFI work programme. The FSB and SSBs will undertake further policy work to enhance authorities' and market participants' ability to identify, monitor and contain systemic risk associated with leverage in NBFI, drawing on the findings of this report.

Notes to editors

The FSB published in November 2020 a Holistic Review of the March Market Turmoil, which lays out a comprehensive and ambitious work programme for strengthening the resilience of the NBFI sector while preserving its benefits. This work is being carried out within the FSB as well as by its member standard-setting bodies and international organisations, to ensure that relevant experiences and perspectives are brought to bear.

The FSB published progress reports to the G20 in November 2021 and November 2022, outlining work to enhance the resilience of NBFI.

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.

For further information on the FSB, visit the FSB website, www.fsb.org.