

Understanding and addressing systemic risks in non-bank financial intermediation

Public research conference, 8-9 June 2022

Annotated Agenda

Objective

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 vulnerabilities and the appropriate financial policy response, working closely with relevant standard setting bodies (SSBs).¹ The FSB's NBFi work programme 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 contributes to the FSB's work to develop a systemic approach to NBFi. It features 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.

Background

NBFi has grown considerably – to almost half of global financial assets, compared to 42% in 2008 – and become more diverse over this period.³ The growth of NBFi implies that risks are

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).

³ See the FSB's *Global Monitoring Report on Non-Bank Financial Intermediation 2021* (December 2021).

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 system resilience depends 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.

At the same time, increased reliance on NBFIs has 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 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. In addition, greater interconnectedness among market participants has accentuated market stress through different parts of the system.

Understanding how the shift towards NBFIs affects the amplification and transmission of shocks 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 NBFIs 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. Finally, there is the question of the effects and potential role of public sector interventions.

Agenda

8 June 2022

Welcome and introduction (13:30 – 13:35 CEST)

Dietrich Domanski (Secretary General, FSB) will introduce the objectives of the conference and logistical arrangements.

Session 1: Liquidity imbalances in bond markets and implications for systemic risk (13:35 – 15:00 CEST)

Chair: Kate Collyer (Chief Economist, UK Financial Conduct Authority)

Papers:

Non-bank financial intermediaries and financial stability – Sirio Aramonte, Andreas Schrimpf and Hyun Song Shin

Presenter: Andreas Schrimpf, Bank for International Settlements

Discussant: Christof Stahel, Investment Company Institute

An unintended consequence of holding dollar assets – Robert Czech, Shiyang Huang, Dong Lou and Tianyu Wang

Presenter: Robert Czech, Bank of England

Discussant: Evangelos Benos, University of Nottingham

Understanding the role of dealer-client relationships in bond trading – Simon Jurkatis, Andreas Schrimpf, Karamfil Todorov and Nicholas Vause

Presenter: Simon Jurkatis, Bank of England

Discussant: Jessica Li, Chicago Booth School of Business

Issues for discussion:

- What are the implications of the growth of bond markets and of changes to the investor base and role of dealers (both bank and non-bank) for systemic risk?
- What are the main drivers of liquidity imbalances in bond markets during episodes of stress? How do the different parts of the NBFIs ecosystem – in

terms of activities and entities – contribute to liquidity imbalances in aggregate?

- Under what conditions could such imbalances result in system-wide stress?

Session 2: Interconnectedness in NBFIs (15:00 – 16:30 CEST)

Chair: John Fell (Deputy Director General, Macroprudential Policy & Financial Stability, European Central Bank)

Papers:

Derivative margin calls: a new driver of MMF flows? – Linda Fache Rousova, Maddalena Ghio, Dilyara Salakhova and German Villegas Bauer

Presenter: Linda Fache Rousova, European Central Bank

Discussant: Alba Patozi, University of Cambridge

You can't always get what you want (where you want it): cross-border effects of the US Money Market Fund Reform – Daniel Fricke, Stefan Greppmair and Karol Paludkiewicz

Presenter: Karol Paludkiewicz, Deutsche Bundesbank

Discussant: Dunhong Jin, Hong Kong University Business School

Intraday liquidity and money market dislocations – Adrien d'Avernas and Quentin Vandeweyer

Presenter: Quentin Vandeweyer, Chicago Booth School of Business

Discussant: Marcin Kacperczyk, Imperial College London

Issues for discussion:

- What types of linkages are most relevant from a financial stability perspective?
- What are the main mechanisms through which liquidity imbalances are transmitted through the financial system? Under what circumstances can these mechanisms act as an absorber (as opposed to an amplifier) of shocks?
- How can interconnectedness in NBFIs be measured and monitored?

9 June 2022

Session 3: Data and tools to enhance risk assessment and monitoring of the NBFi sector (13:30 – 15:00 CEST)

Chair: Steffen Kern (Chief Economist and Head of Risk Analysis, European Securities Markets Authority)

Papers:

Systemic risk pro-cyclicality in the European financial system – Peter Cincinelli, Elisabetta Pellini and Giovanni Urga

Presenter: Elisabetta Pellini, Bayes Business School

Discussant: Wenqian Huang, Bank for International Settlements

Contagion from market price impact: a price-at-risk perspective – Gábor Fukker, Michiel Kaijser, Luca Mingarelli, and Matthias Sydow

Presenter: Matthias Sydow, European Central Bank

Discussant: Silvia Pezzini, Hong Kong Monetary Authority

Increasing corporate bond liquidity premium and post-crisis regulations – Botao Wu

Presenter: Botao Wu, New York University

Discussant: Jun Pan, Shanghai Advanced Institute of Finance

Issues for discussion:

- Which indicators can be used to monitor risks in the NBFi sector? How can existing data sources be used more effectively for this purpose?
- Should further reporting or disclosure requirements be considered to enhance risk monitoring and the preparedness of authorities and market participants?
- To what extent can tools such as stress testing be used to assess NBFi risks from a forward-looking perspective? What other tools can be used?

Session 4: Policy tools and approaches to address systemic risk in NBFi (15:00 – 16:15 CEST)

Chair: Marina Moretti (Assistant Director, Financial Supervision and Regulation Division, International Monetary Fund)

Papers:

Financial fragility in open-ended mutual funds: the role of liquidity management tools
– Lorenz Emter, Falko Fecht and Oana Peia

Presenter: Falko Fecht, Frankfurt School of Finance and Management

Discussant: Andrew Metrick, Yale University

(In)efficient repo markets – Tobias Dieler, Lorian Mancini and Norman Schürhoff

Presenter: Tobias Dieler, University of Bristol

Discussant: Carolyn Sissoko, University of the West of England

Exorbitant privilege? quantitative easing and the bond market subsidy of prospective fallen angels – Viral Acharya, Ryan Banerjee, Matteo Crosignani, Tim Eisert and Renee Spigt

Presenter: Matteo Crosignani, Federal Reserve Bank of New York

Discussant: Jane Li, Columbia University

Issues for discussion:

- What tools and approaches are most relevant for addressing systemic risk in NBFIs? How can authorities ensure that the framework used to regulate non-banks from a financial stability perspective is comprehensive and coherent?
- Should the focus be mainly on redeploying existing NBFIs policy tools (e.g. in terms of their design or use) or on adding new tools to close any gaps?
- To what extent should certain NBFIs policy tools be designed, implemented or activated by authorities, rather than be left to market participants?

Conclusions and wrap-up (16:15 – 16:30 CEST)

Dietrich Domanski (Secretary General, FSB) and **Martin Moloney** (Secretary General, IOSCO) will provide concluding remarks and describe next steps.