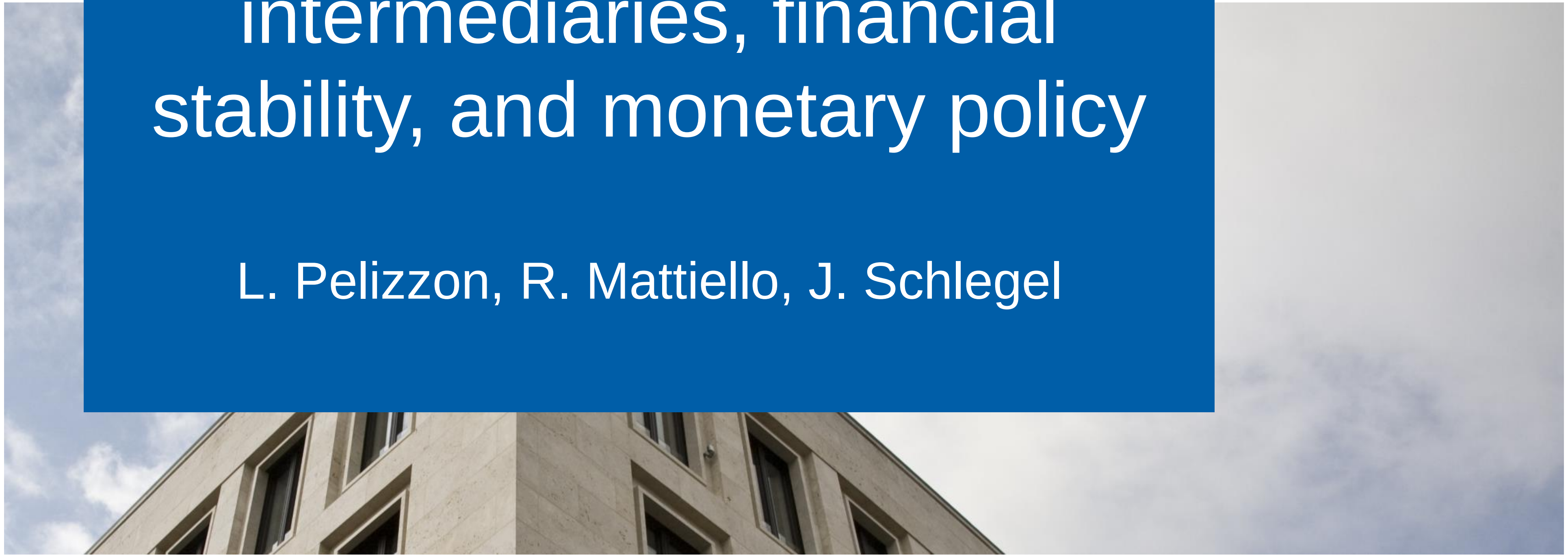
LEIBNIZ INSTITUTE SAFE
Sustainable Architecture for Finance in Europe



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

L. Pelizzon, R. Mattiello, J. Schlegel

Objective

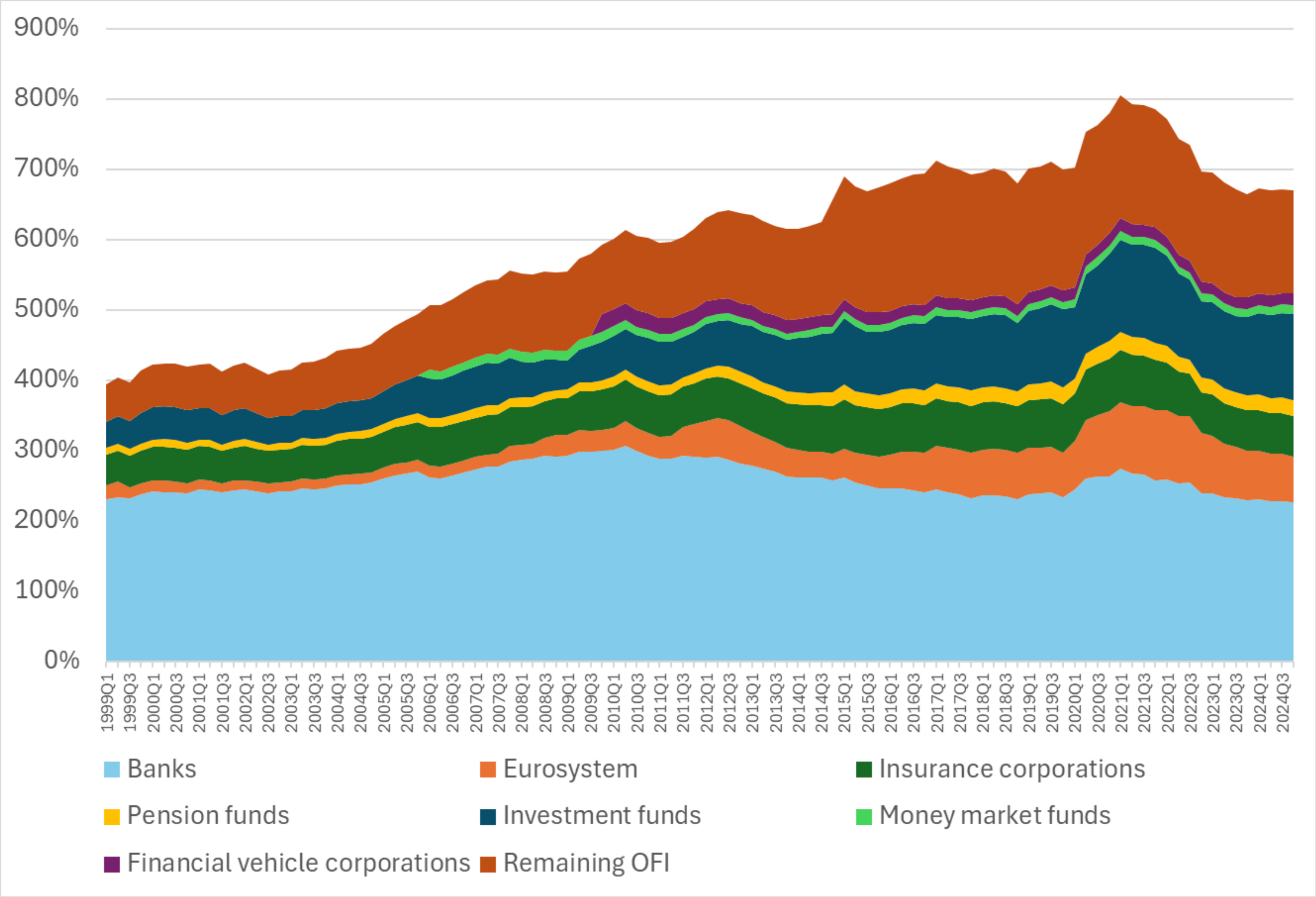
- How large is the financial system in the euro area? How does it compare with the US?

- How much are EU NBFIs supporting the real economy?

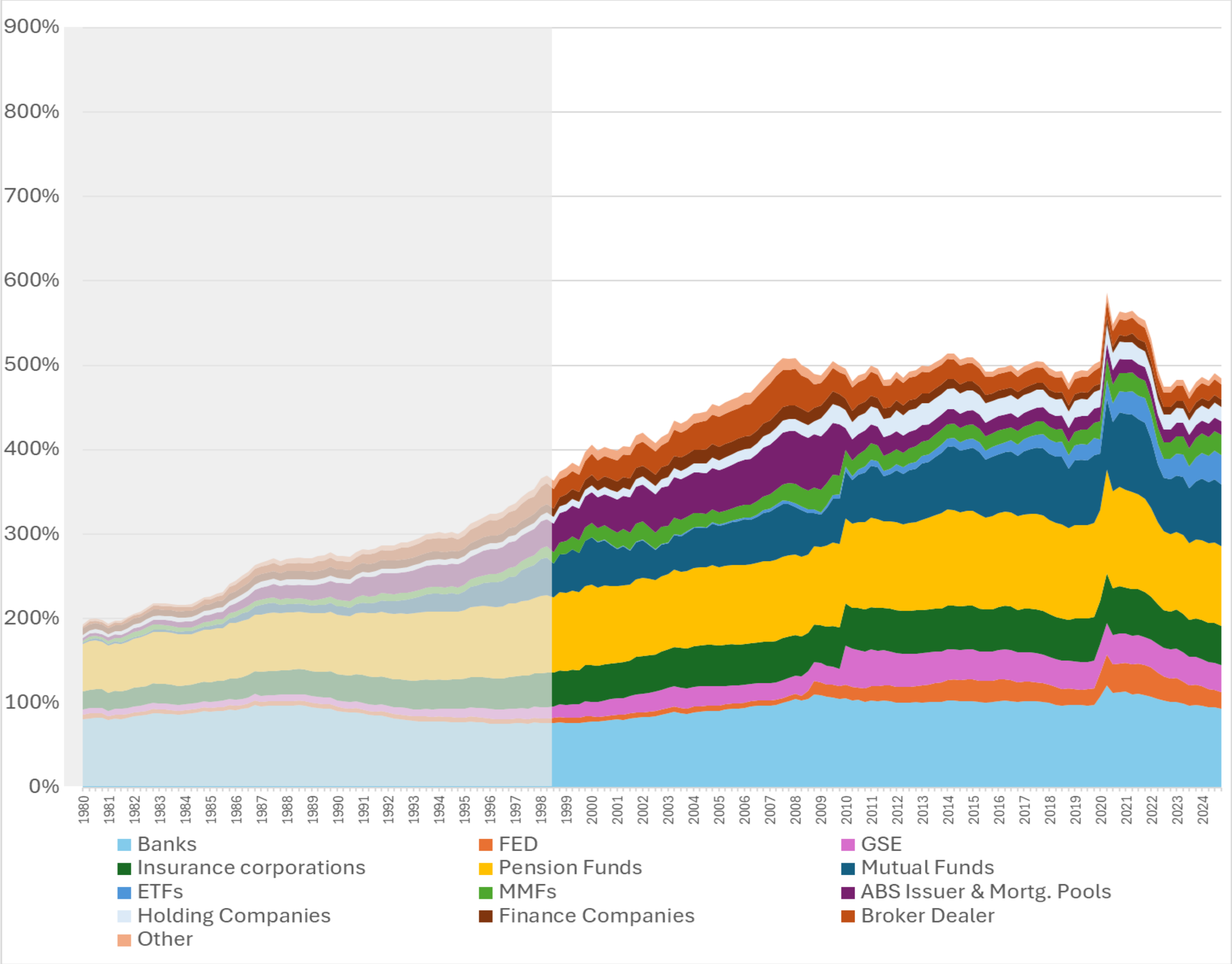
- How NBFIs reshape financial stability and Monetary Policy transmission?
  - Should NBFIs access CB balance sheets?

- How could EU NBFI help (or benefit from) CMU/S&I?

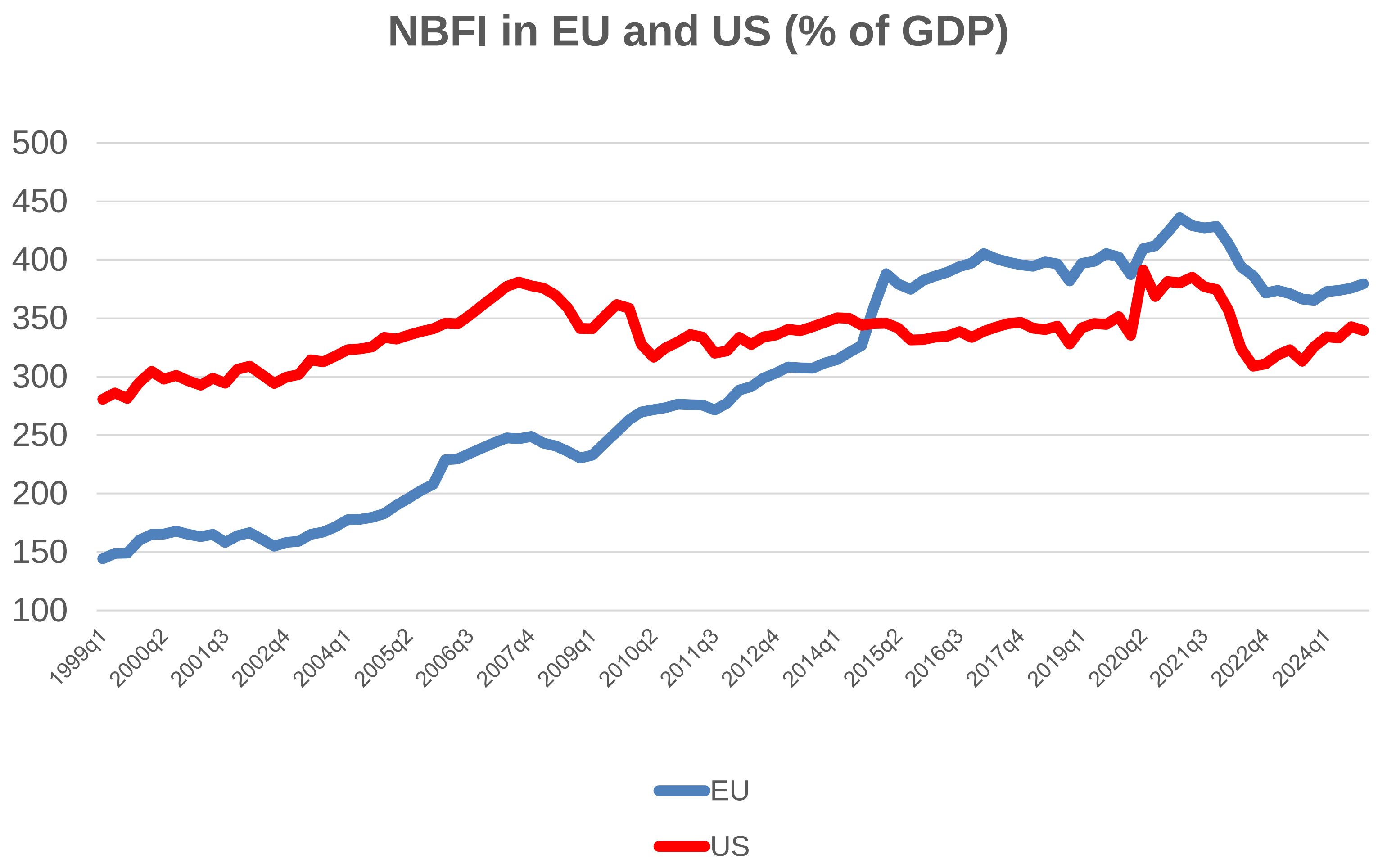
Financial System in Europe (% of GDP)



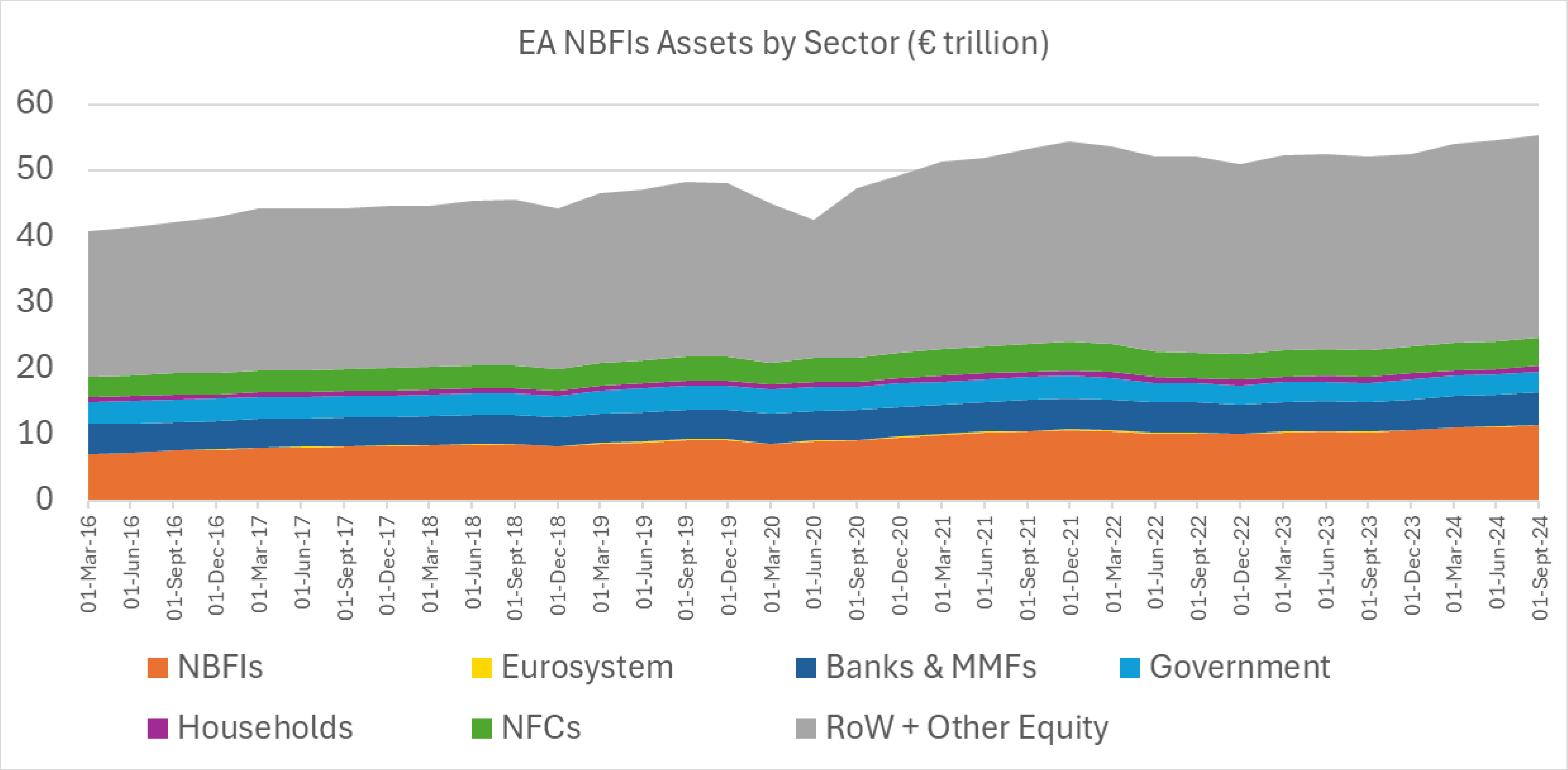
Financial System in the US (% of GDP)



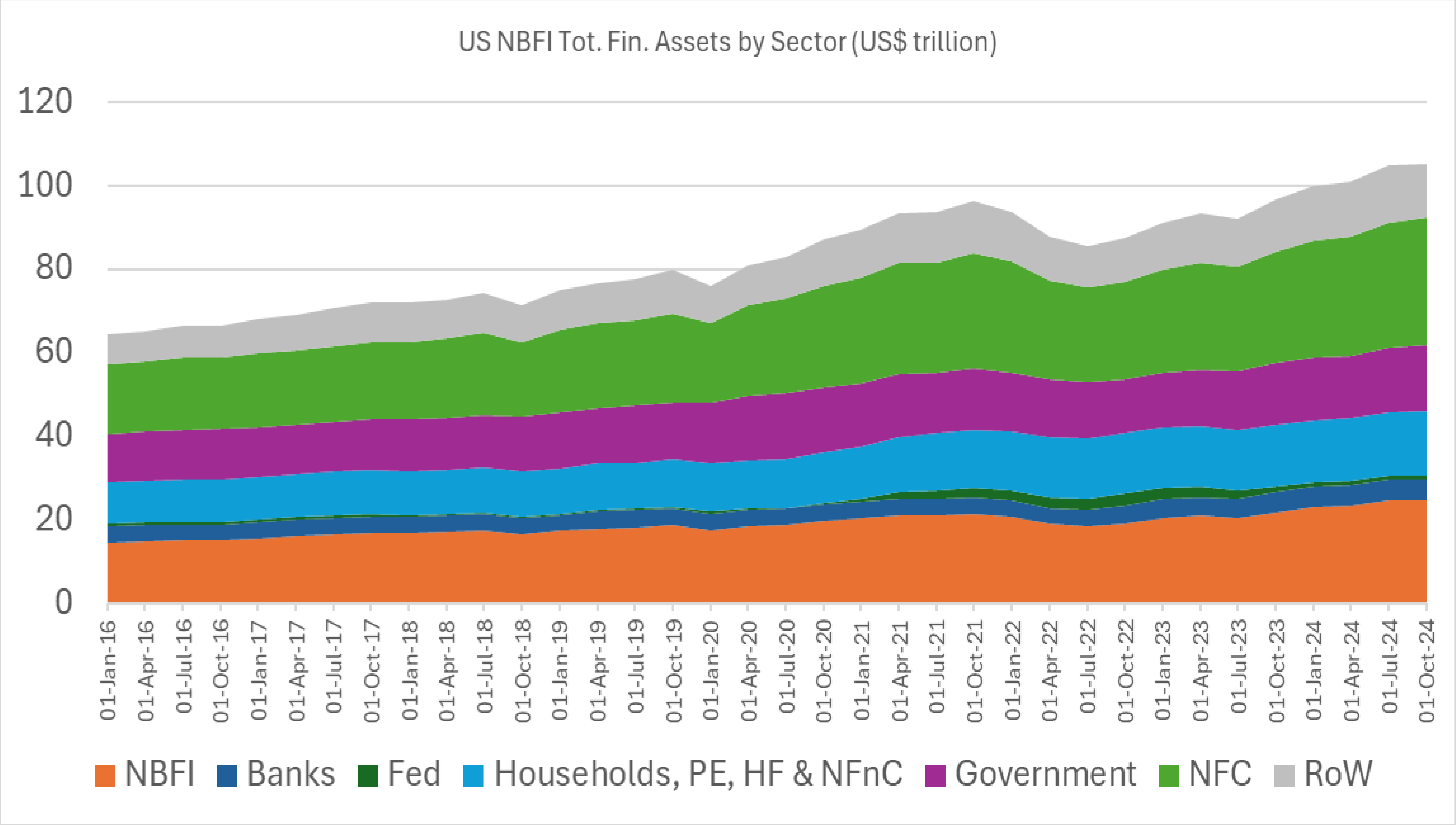
A comparison



Where are NBFIs investing? NBFI Asset Allocation



And the US? US NBFI Asset allocation



Why is EU NBFI sector so large and largely investing abroad?

The Euro Area:

- *has lower GDP growth*
- *financial system has lower direct access to Capital Markets and has longer intermediation chains*
- *saving rates are higher than in the US*
- *savings are largely managed by global asset managers (as for banks, we do not have NBFI champions like BlackRock)*
- *has an underdeveloped, fragmented, segmented Capital Market (including the sovereign bond market)*
- *……*

EU NBFIs are an opportunity for domestic capital market development. (so far missed!)

Suggestion

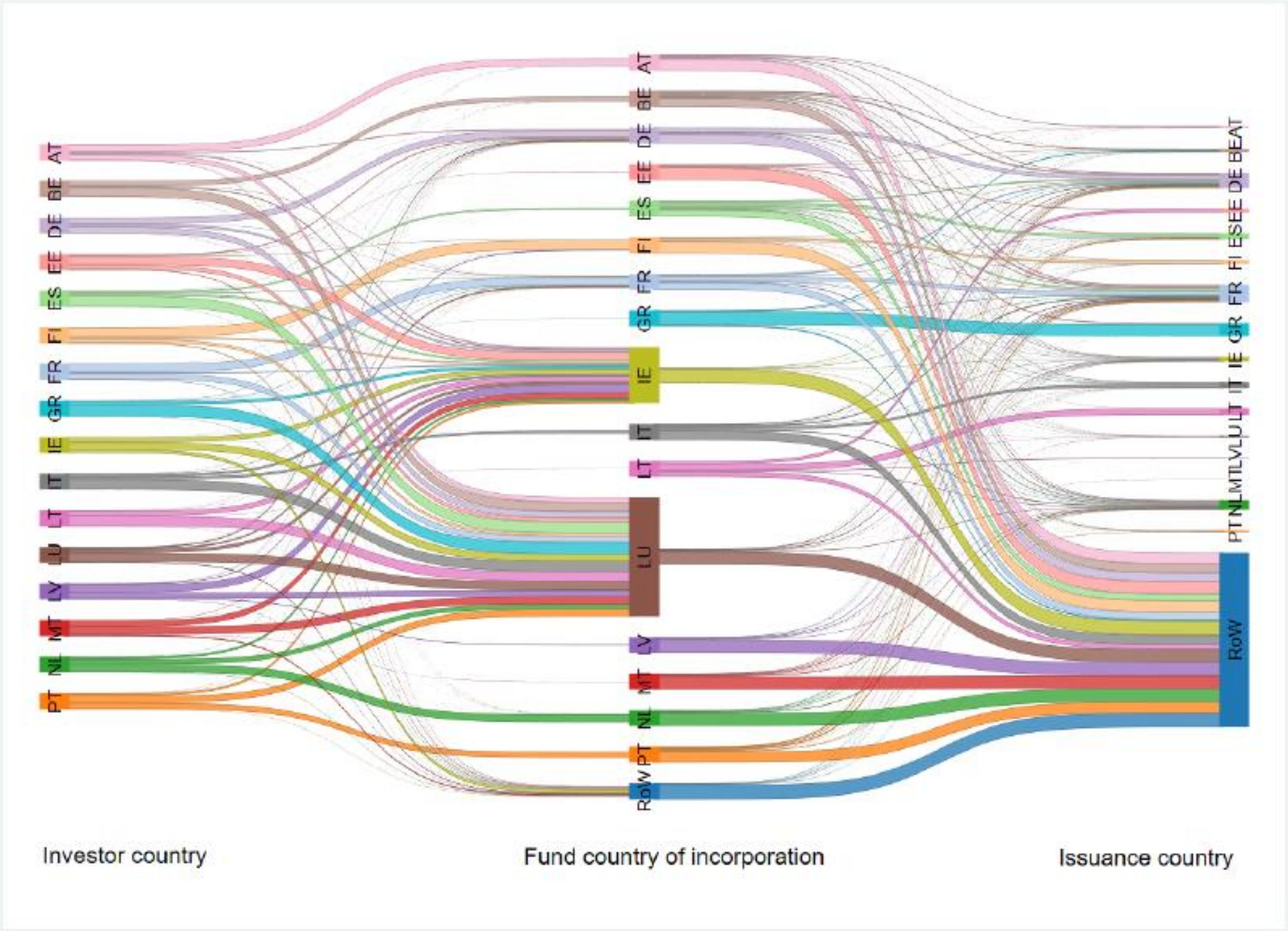
Develop the Savings and Investment Union:

- Advancing this initiative would help channel **more NBFI capital within Europe**, boosting domestic funding sources and strengthening integration, including sovereign bond markets.

Important role for NBFIs in developing S&IU:

- NBFIs face fewer cross-border barriers than banks!

Any investment cross border barriers?



Sources: Lambert, Molestina Vivar and Wedow (2024), Figure 2

Key takeaway and suggestion

Untapped Potential of NBFIs:
NBFIs could **foster cross-border capital flows**

Enhance Capital Market Infrastructure:

- well-functioning securitization system of both **covered bonds** and **Asset-Backed Securities** (e.g., for mortgages and SMEs)

- Private Credit and Private Equity (?)

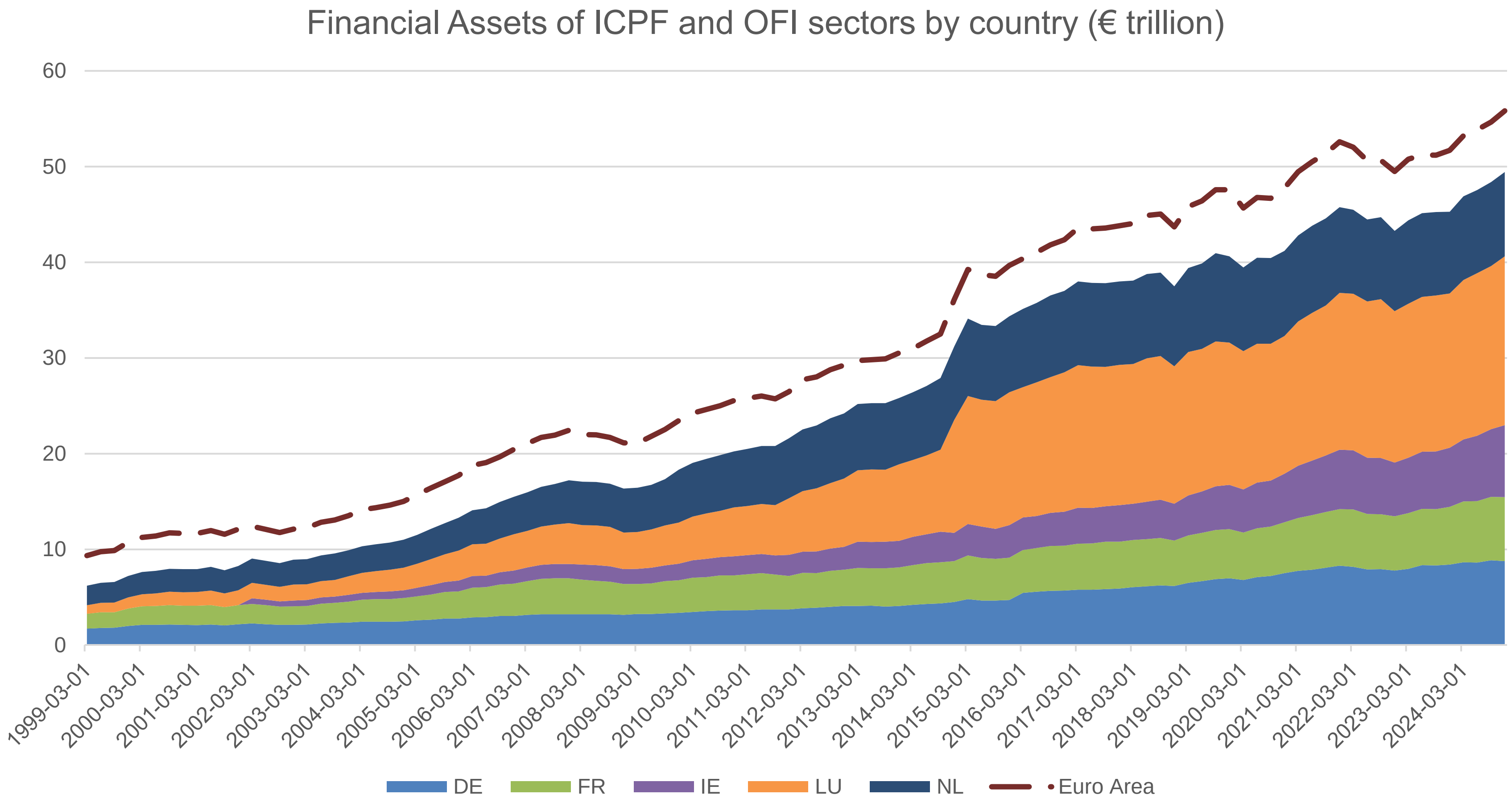
What about NBFIs and systemic risk?

- *5 traditional indicators*: **size**, **interconnectedness**, substitutability, complexity, and cross-jurisdictional activity

- *6 specific indicators*: Leverage, Liquidity Mismatch, Maturity Transformation, **Risk Concentration** and Correlation, procyclicality of behavior and **links to core financial institutions** (see Acharya, Cetorelli and Tuckman (2024))

- *3 other indicators*:
  1. **Opacity and Data Gaps**
  2. **Inadequate Supervisory Coordination and Fragmentation**
  3. **Moral Hazard and Central Bank Dependence**

2. Inadequate Supervisory Coordination and Fragmentation



Need for a **unified supervisory mechanism**

3. Moral Hazard and Central Bank Dependence

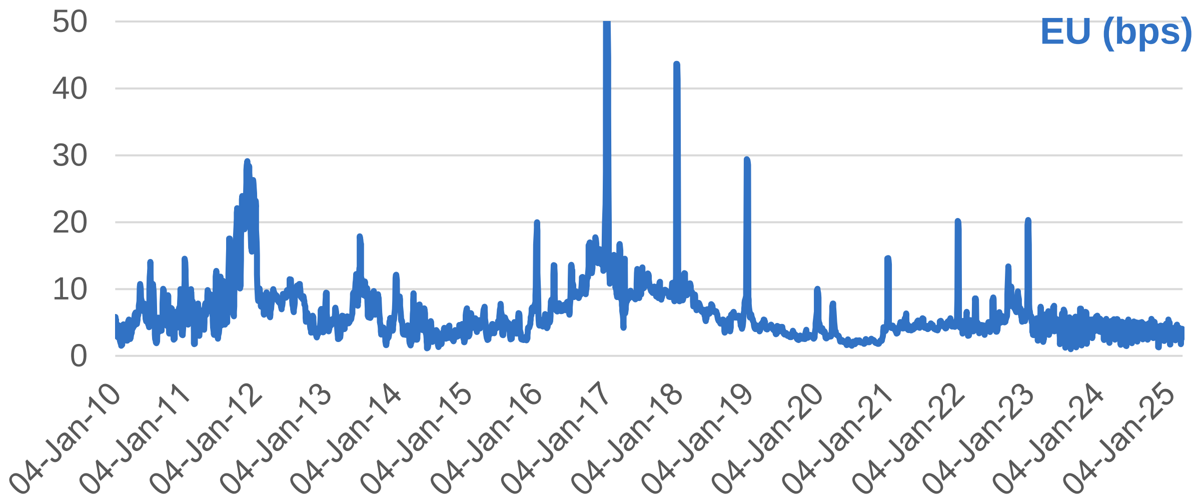
- Expectations of central bank interventions during crises, such as liquidity backstops or asset purchases, create moral hazard.
- NBFIs may engage in excessive risk-taking under the assumption of eventual rescue.
- This undermines market discipline, can lead to misallocation of resources and financial instability (see Cieslak et al. (2021) and Buiter et al. (2023)).

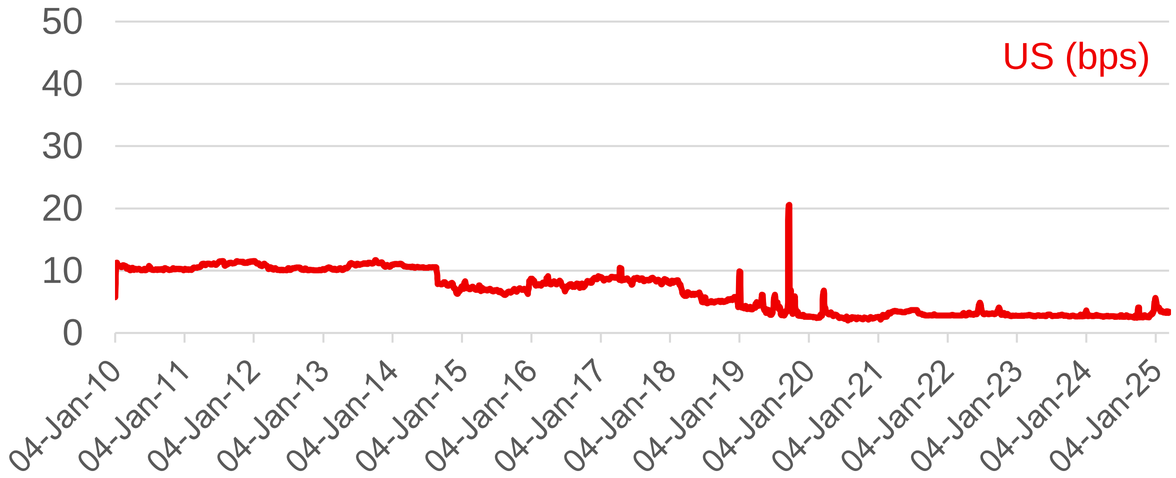
The Role of NBFIs for Monetary Policy

- Credit and Deposit Channel
- Exchange rate channel
- Expectations Channel
- Risk-Taking, Collateral, and Asset Pricing Channels
- **Interest Rate Channel**
  - **large footprint of NBFI in financial markets (ESRB NBFI Monitor 2025)**

Should CBs give access to their balance sheets to NBFI?

All in the corridor: EU and US dispersion index





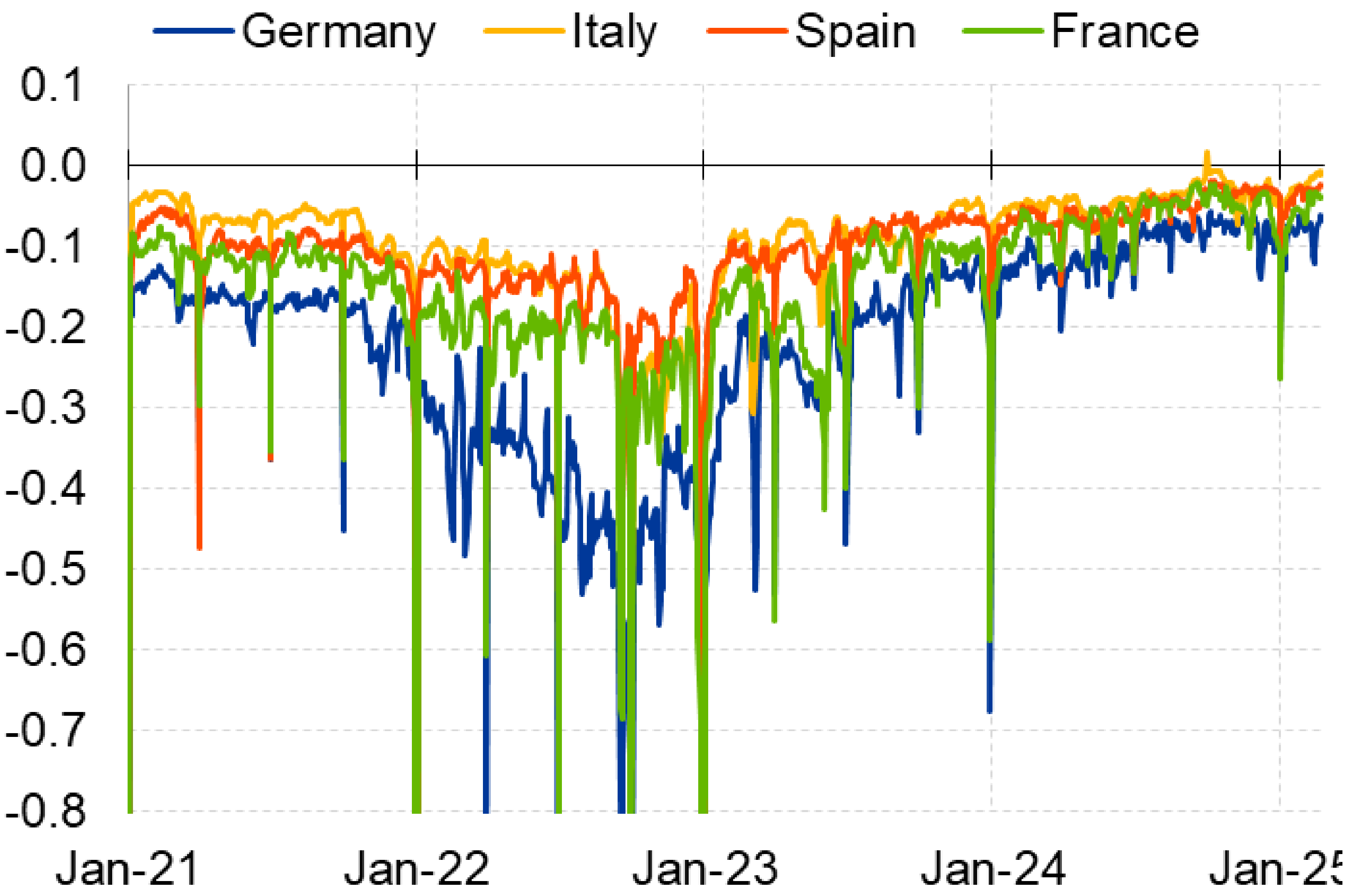
DK (2016): dispersion index

$$D_t = \frac{1}{\sum_i v_{i,t}} \sum_i v_{i,t} \left| \hat{y}_{i,t} - \bar{y}_t \right|,$$

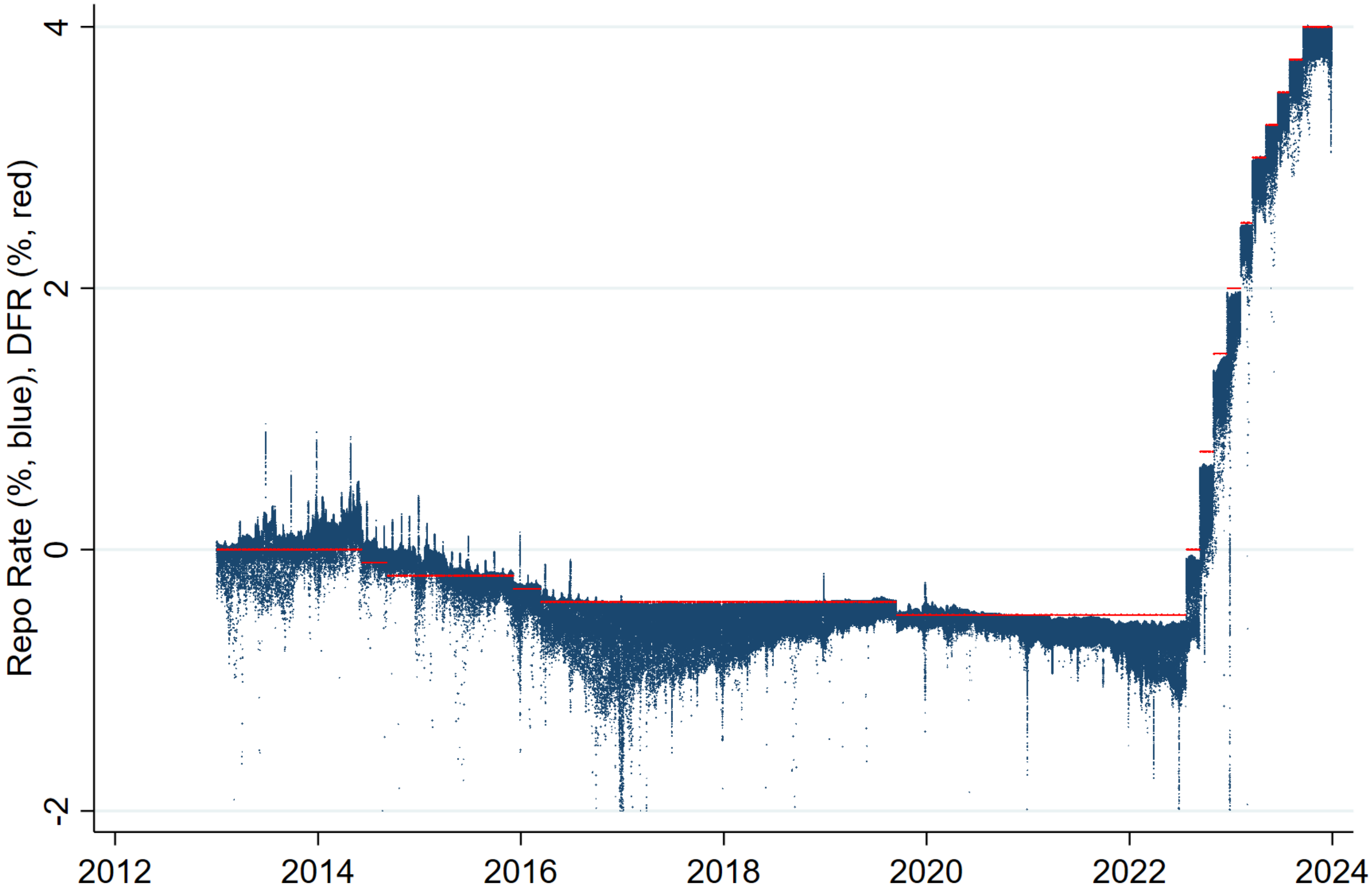
EU: EONIA, €str, GC, SC repo

US: ON RRPs, EFFR, IORB, IORR, OBFR, SOFR, LIBOR, TP repo

Why is this the case?



Why is this the case?



Would NBFI access to the CB balance sheet help to keep rates in the corridor?

What are the CB facilities for NBFIs in place?

- ON RRP (Fed) – in place since 2014
- Contingent Non-Bank Repo Facility (BoE) – never used

What would be needed to reduce the dispersion in EA?

- Security Lending Facility

Suggestion

Access to CB's balance sheet only as a backstop in the presence of collateral scarcity and stress episodes:

- **Collateral scarcity (corridor floor):**
  extending the *Securities Lending Facility*
- **Stress episodes (corridor cap)** operationalizing a dedicated *Contingent NBFI Repo Facility*

to key NBFI participants (under appropriate regulation)

Conclusion

1. *Develop the Savings and Investment Union:*
   would **help channel more NBFI capital within Europe**

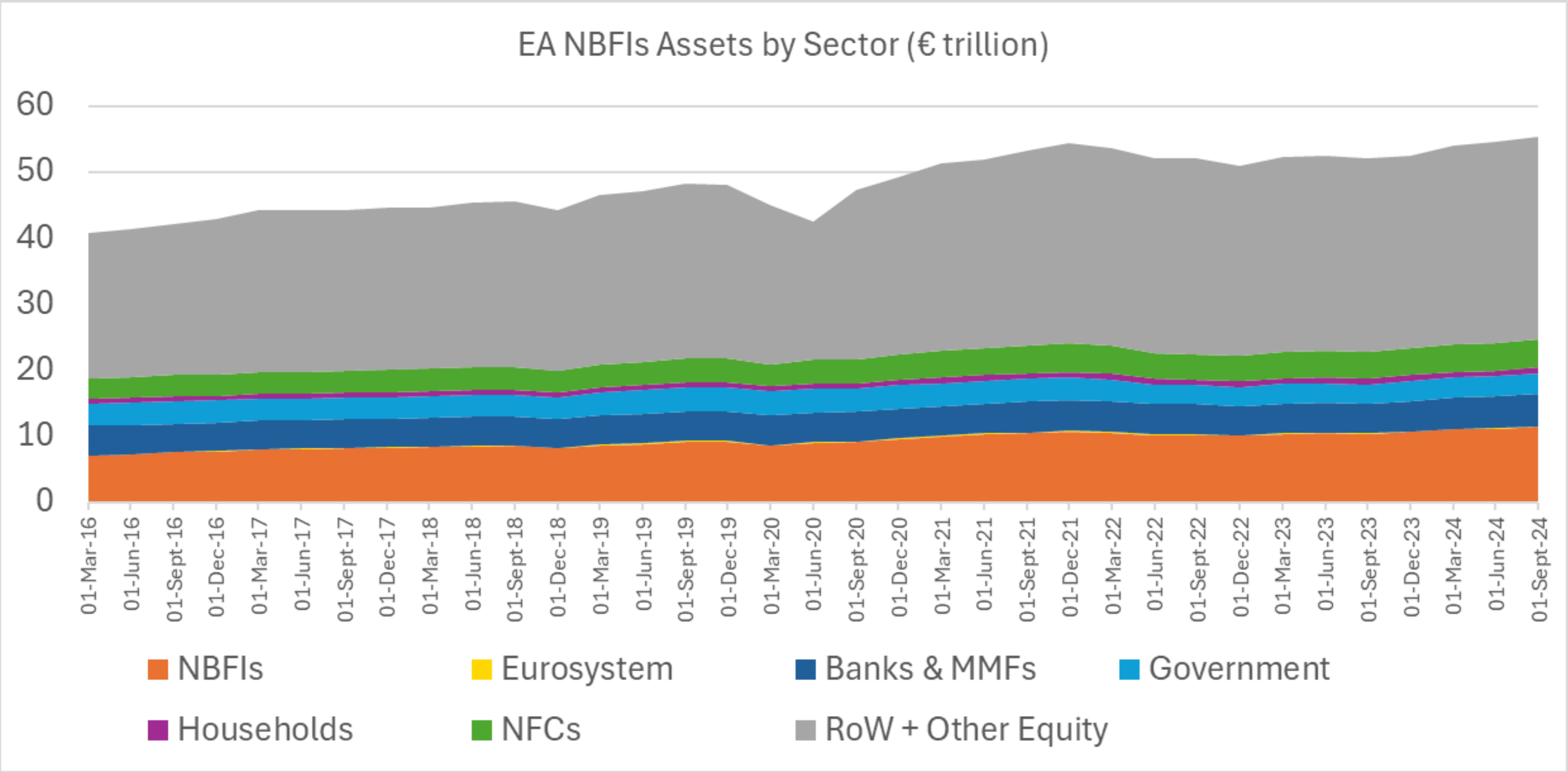
2. *Enhance Capital Market Infrastructure:*
   covered bonds and Asset-Backed Securities would unlock **NBFI participation in critical credit markets** without the cross-border issues that banks face.

3. *Strengthen Supervisory Frameworks:*
   enhanced, harmonized, **unified supervisory mechanism** at the EA level to **mitigate systemic risks** due to NBFI country-level concentration activity

4. *Access to CB's balance sheet only as a backstop in the presence of collateral scarcity and stress episodes:* **Securities Lending Facility** and the **Contingent NBFI Repo Facility** to key NBFI participants (under appropriate regulation)

Thank you!

Where are NBFIs investing? NBFI Asset Allocation



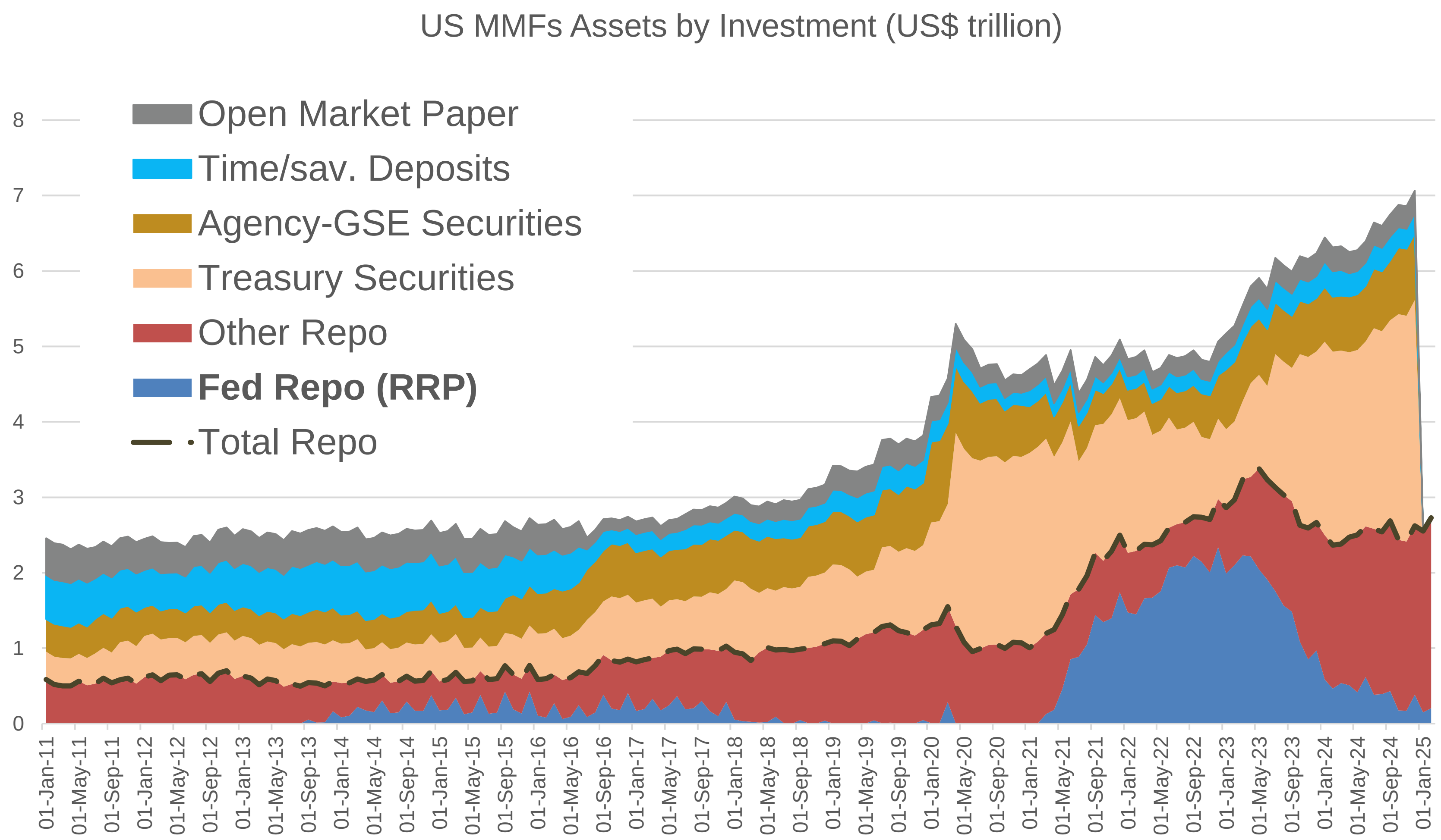
The CB dilemma

Duffie and K 2016 theoretical model:

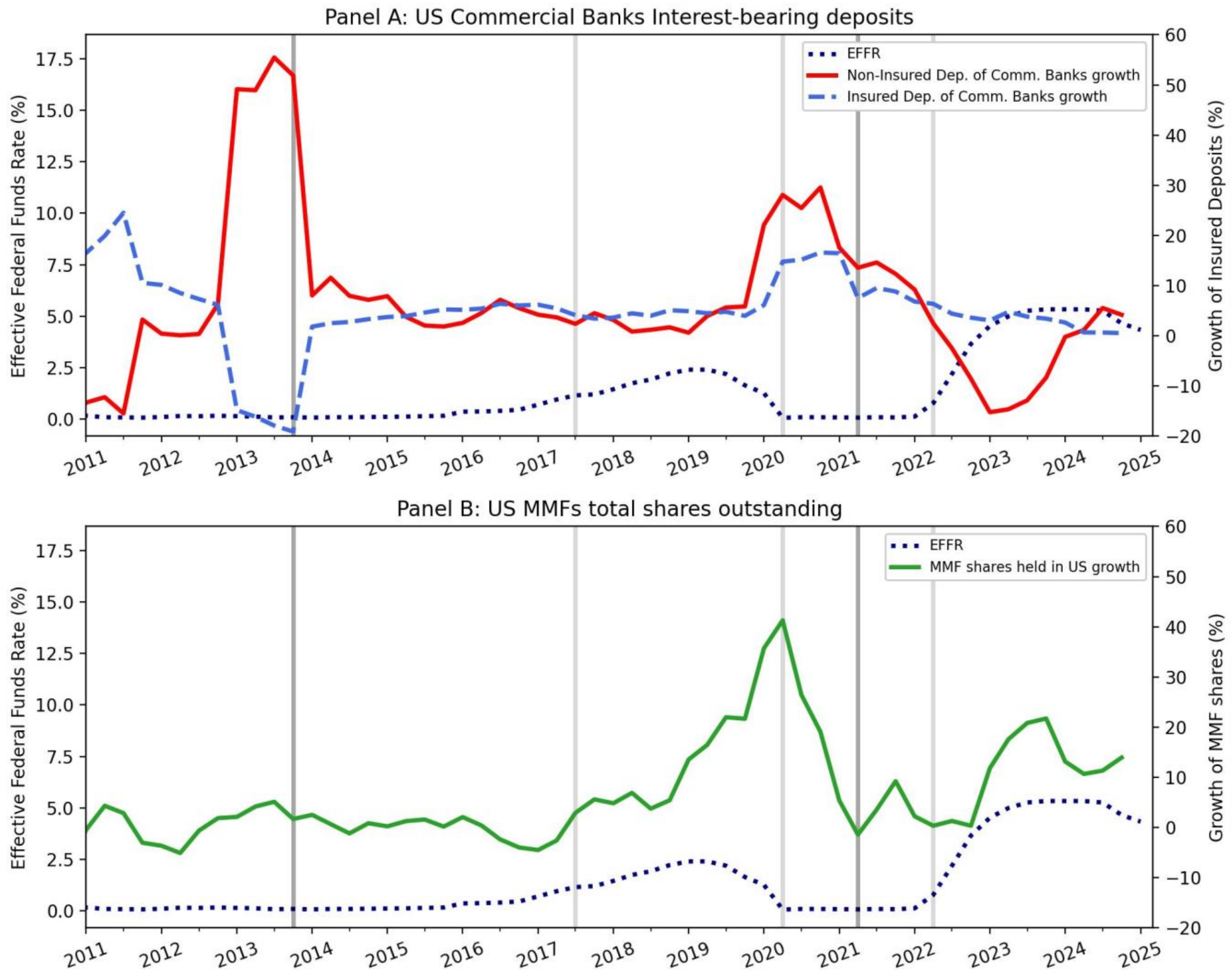
+ the Fed’s overnight reverse repurchase (RRP) facility **improves the pass-through** of changes in Fed policy rates into average wholesale money market rates (everything in the corridor).

- this improvement in average pass-through is achieved mainly through the **disintermediation of bank deposits**

Is that really the case?



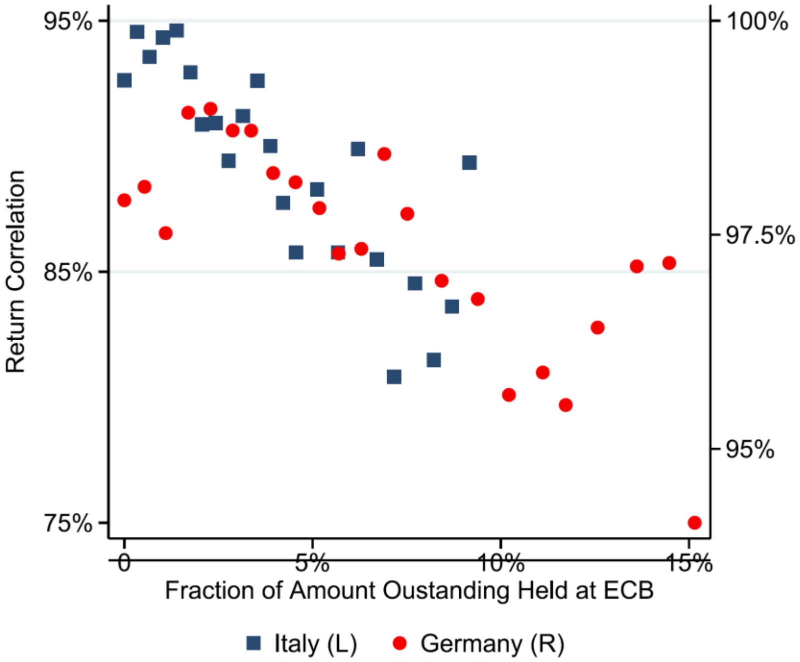
Relationship between interest rates and deposit dynamics

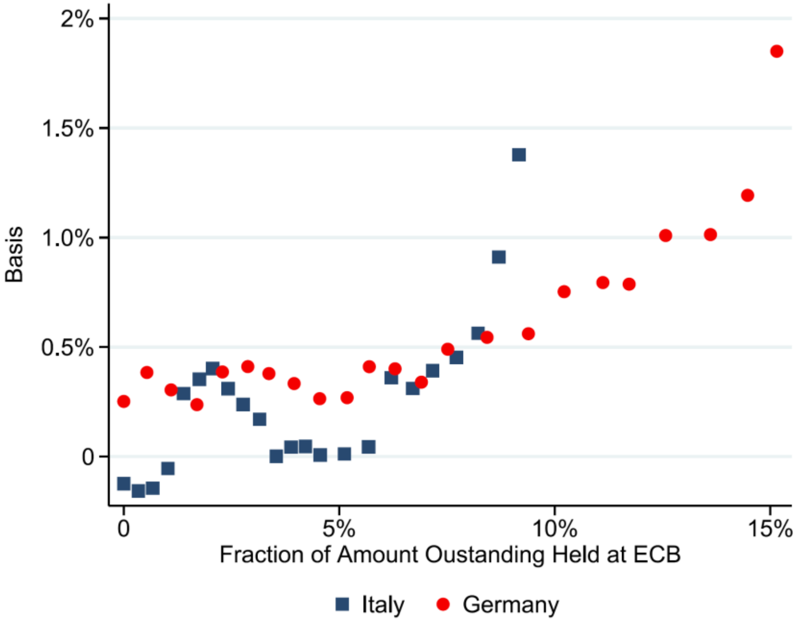


But they are not so efficient….

Category	Europe	United States
Equity Funds	1.47	0.40
Bond Funds	0.94	0.38
Mixed/Hybrid Funds	1.48	0.58
ETF	0.23	0.16
Money Market Funds	0.16	0.22

Central bank-driven mispricing, Pelizzon et al. (JFE2025)





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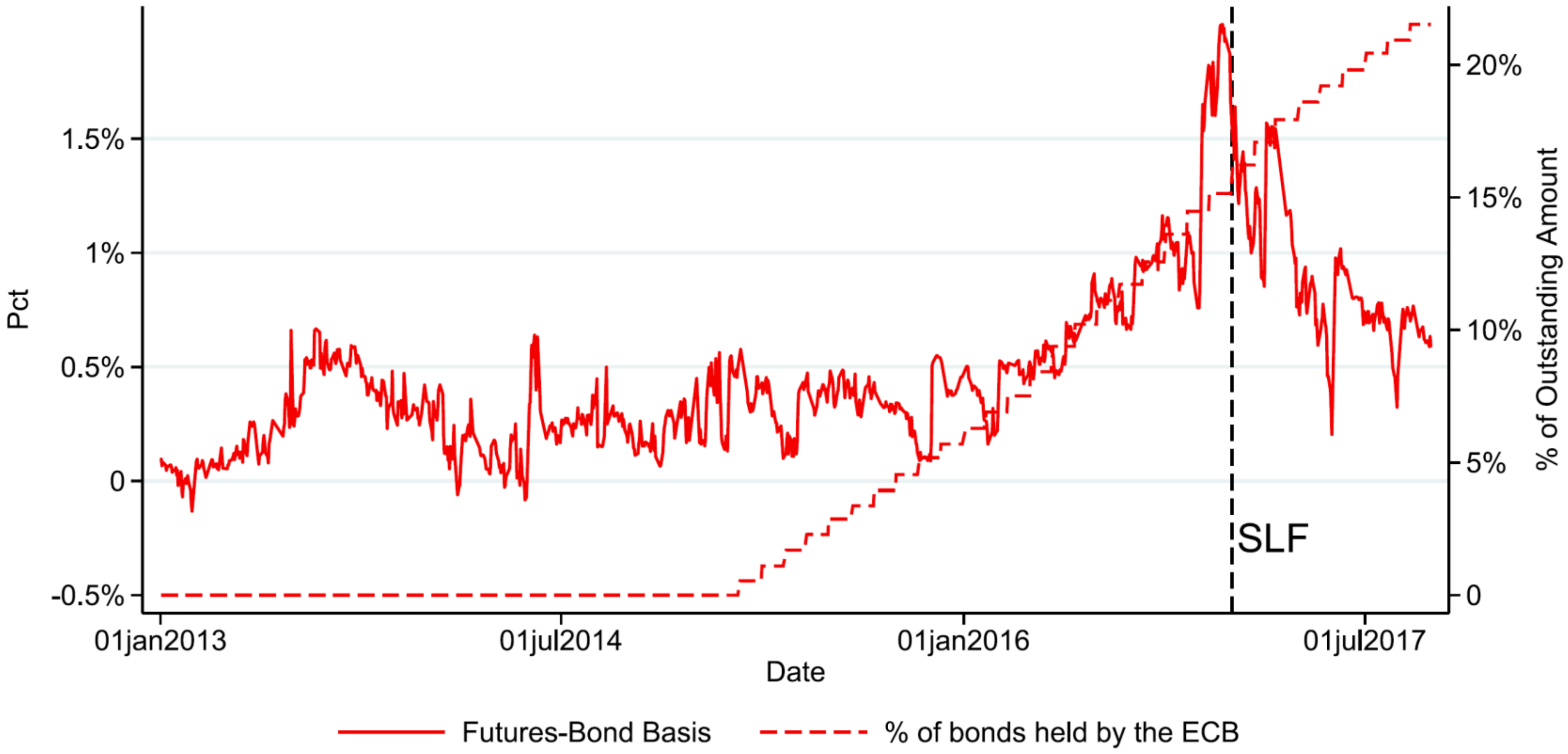
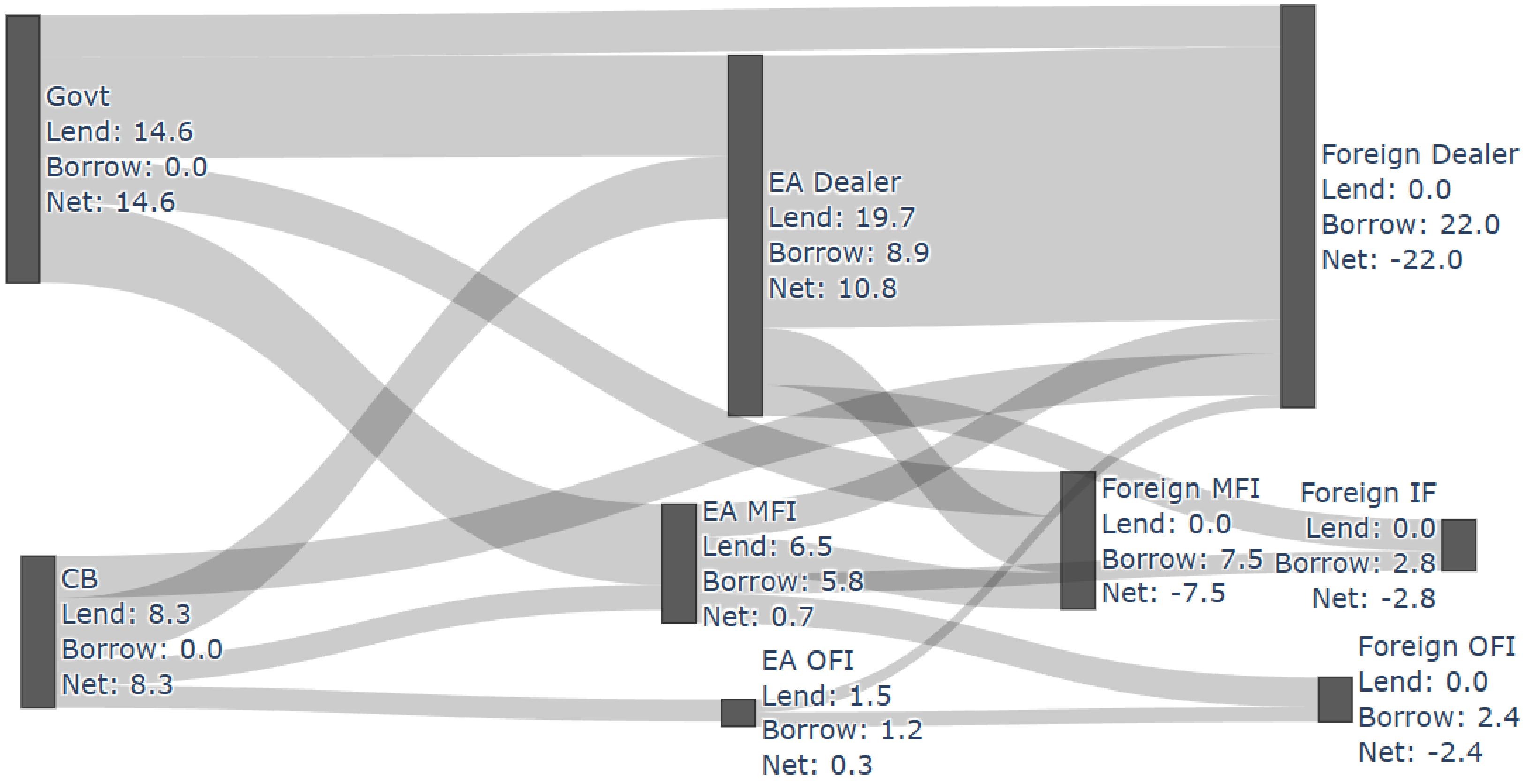


Bund Repo Market Structure in 2022: Flows between Sectors



Changing Architecture of Financial Intermediation