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IMF calls on global financial regulators to step up supervision of nonbank financial institutions

Article

The news: In a recent blog post, the International Monetary Fund (IMF) stressed the risks that nonbank financial institutions (NBFIs) pose to the financial system and warned that their lack of regulatory oversight could cause the next global financial crisis.

Global acceleration: Since the 2008 financial crisis, the growth of NBFIs—institutions like pension funds, insurers, and hedge funds—has exploded. As of 2021, NBFIs held about $239 trillion in assets, according to the Financial Stability Board, or nearly half of global financial assets.

- The recent turmoil in the US and European banking sectors prompted the IMF to warn global policymakers that financial risks could intensify over the next few months, and that many of them could potentially stem from NBFIs.
- The financial agency called on regulatory bodies from all nations to increase oversight and regulation of NBFIs and to ensure proper risk management practices are in place.

What are the risks? The IMF's blog post identified three major risks posed by NBFIs, the effects of which have been enhanced by many years of low interest rates and low volatility.

- **Increased leverage:** Low rates and low asset values incentivize NBFIs to use increased leverage to boost their returns. But the recent shakiness in financial markets means highly leveraged firms are more vulnerable to sudden shifts in asset values, which means any financial loss is amplified.
- **Liquidity mismatch:** Similar to what happened at **Silicon Valley Bank**, an NBFI may also face a situation in which it can't generate cash quickly enough to meet customer redemption requests.
- **Interconnectedness:** NBFIs have simplified cash flow within the global financial sector and made it more efficient. But NBFIs often link to other NBFIs and directly with banks, causing both entities to have exposure to the same assets or counterparties. Thus any stress an NBFI experiences can more easily spread to the banking sector.

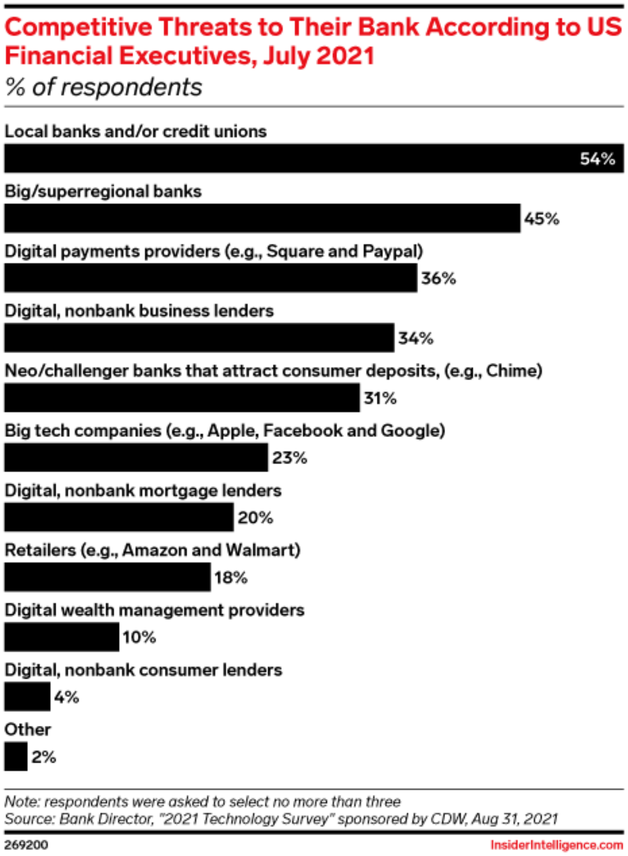
Even more specific risks: In the US, regulatory agencies and bank heads have warned about the risks NBFIs pose to the US financial sector. Some agencies have taken steps to monitor NBFIs, but have stopped short of regulating them.

- Last month, in a letter to shareholders, **M&T Bank** CEO René Jones urged lawmakers to hold alternative lenders to the same regulatory standards as traditional banks. One of his major points was around how NBFIs weren't required to adhere to the Community Reinvestment Act.

- Late last year, the Consumer Financial Protection Bureau (CFPB) proposed a new rule that would create a publicly available database of NBFIs which outlines any of their financial violations. It claimed the database would allow consumers to do their own due diligence before deciding to work with an NBFI.
- The lack of regulations around NBFIs largely applies to fintechs as well. Financial regulators, such as the Office of the Comptroller of the Currency (OCC), have come down on banks for not properly managing risks associated with fintech partnerships. But banks argue that the onus for risk management shouldn't solely fall on them.

The bottom line: Even before the recent upheaval in the global banking industry, much of the sector was outspoken on the risks NBFIs pose, and the harm that the lack of regulations around NBFIs could ultimately cause to the entire global financial system. Consumer complaints have also ramped up, largely related to new technologies NBFIs offer like buy now, pay later (BNPL) and digital currencies.

Financial regulators have seemingly stalled on regulations due to the complex interconnectedness of NBFIs and the regulated banking sector, and the quickly developing innovation that NBFIs bring to the financial sector. But they can no longer stall on cracking down on NBFIs. Delays could lead to an even more complex situation that could have lasting impacts.



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