Discussion of A leaky pipeline: Macroprudential policy shocks, non-bank financial intermediation and systemic risk in Europe

Johanna Krenz and Akhilesh K Verma

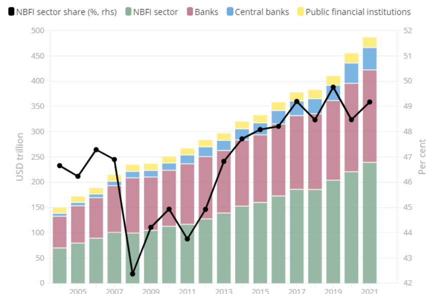
Discussed by
Teng Wang
Federal Reserve Board

EBA Policy Research Workshop 2024

The views expressed in this presentation are solely the responsibility of the authors and do not necessarily reflect those of the Federal Reserve Board or the Federal Reserve System.

In a nutshell

- Post-GFC, regulators adopted more macroprudential policies.
- Concurrently, nonbank financial institutions (NBFI) have grown significantly.
  - The global assets of NBFIs passed $200 tln, comprising 49.5% of the total global financial assets.



Source: Financial Stability Board report on non-bank financial intermediation (2022) based on-jurisdictions' 2022 submissions (national sector balance sheet and other data); FSB calculations.

- This paper: With the role of NBFIs growing in the financial sector, it is important to consider how these macroprudential policies impact the entire system, and not just traditional banks.

Research Questions

- the Focus: Effectiveness of macroprudential policies (MaPs) in reducing systemic risk across the financial system.
  - Examination of regulatory leakages to non-bank financial intermediaries (NBFIs) that may undermine policy effectiveness.
  - This paper: Macroprudential policy aims to reduce systemic risk, yet its focus on traditional banks may neglect significant risk factors in NBFIs.

Key Findings

- Methodology: Analysis using $\Delta CoVaR$ as a measure of systemic risk in response to MaP shocks.
  - Large dataset covering 600 financial institutions across 20 European countries (2005-2018).
  - MaP shocks are classified into demand-, supply-, liquidity-, and capital-targeted measures.
- Findings:
  - Both positive MaP demand and MaP supply shocks (tightenings) elevate systemic risk for NBFIs.
  - Capital measures may inadvertently increase NBFI systemic risk.
  - MaP demand measures significantly reduce system risk among traditional banks, while the effects of supply measures are small and insignificant.
  - Effects of different MaP measures on systemic risk are different between core and peripheral European countries.
    - Caused by different macroprudential stances and different sizes of NBFI sectors in each country.

Contribution is significant

- Novel Examination of Macroprudential Policy Impact:
  - The paper uniquely explores how macroprudential policies affect traditional banks and non-bank financial intermediaries (NBFIs) within a single framework.
  - Provides insights into regulatory leakage, a critical area with implications for financial stability.
- Policy-Relevant Findings:
  - Demonstrates that certain MaP measures may inadvertently increase systemic risk by driving risk to less-regulated NBFIs.
  - Highlights the need for regulatory adjustments targeting the NBFI sector to strengthen overall systemic risk management.
- Empirical Contribution:
  - Uses a large, granular dataset across European countries, allowing for detailed analysis of systemic risk shifts due to MaP shocks.
  - The methodology incorporates ΔCoVaR to capture risk spillovers.

Are the Findings Important?

Yes! Considering the strong growth of NBFI and the popularity of MaP measures.

THE BANKER

Analysis & opinion | Banking markets | Technology | Policy & trends | Regulation | Sustainability | World | Awards | Rankings & data

REGULATION ■ MAY 23

Stable NBFI sector cannot be achieved using bank rules, says EU official

European Commission launches consultation on macroprudential policies for non-banks

by Barbara Pianese

Overall Assessment

- Clearly an important topic
- In Europe, most macroprudential policies are ineffective at reducing systemic risk.
  - Mainly driven by regulatory arbitrage—increase in systemic risk among NBFI intermediaries.
  - Must broaden regulations to cover NBFIs Use macroprudential shocks to study the impact of leakages on systemic risk.
  - Determinants: different types of NBFIs, different types of MaPs.
- Paper carries important implications in the current economic environment.
- My focus will be on understanding and extending the interpretation of results.

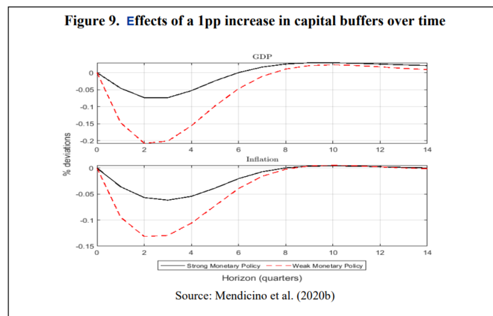
Comment 1

- Macroprudential Shock Identification:
  - Specific macroprudential policy can be a response to changes in financial structure
  - Countries with weaker financial regulatory regimes may need to adjust their MaP r
- Measurement of Systemic Risk ($\Delta CoVaR$):
  - While ΔCoVaR is a strong choice, adding complementary measures such as SRISK validate findings across different risk dimensions.
  - This multi-measure approach could strengthen conclusions on systemic risk spillove smaller, high-volatility NBFIs.

sectionComments

Comment 2

- Overlapping Effects of Monetary and Macroprudential Policies:
  - Monetary policy adjustments can influence systemic risk through credit conditions and asset prices, potentially amplifying or dampening the effects of MaP measures.
  - MaP shocks in the study could be partially confounded by concurrent monetary policy shifts, especially in periods of tightening or loosening by central banks.



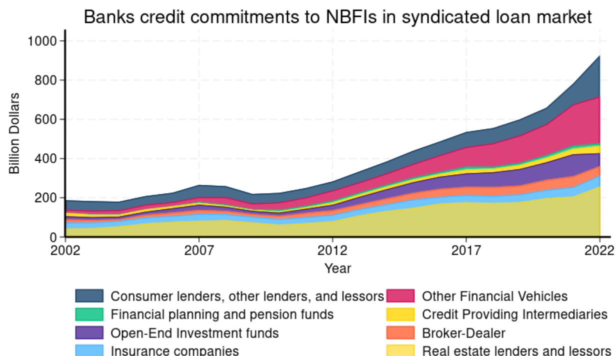
Source: Mendicino et al. (2020b)

Comment 2

- Potential Impact on Non-Bank Financial Intermediaries (NBFIs):
  - NBFIs may respond differently to macroprudential policies depending on prevailing interest rates and liquidity conditions set by central banks.
  - For example, low interest rates can drive NBFIs toward higher leverage and risk-taking, which may interact with capital-targeted MaP measures to alter systemic risk outcomes.
- Potential Checks:
  - Consider controlling for monetary policy stance (e.g., including an interest rate variable) to isolate the independent effects of MaP on systemic risk.
  - A robustness check with separated periods of monetary policy tightening and loosening could provide additional insights into the distinct and combined effects of MaP.

Comment 3

- The Channel
  - Different NBFIs engage with banks differently (Krainer et al. 2024; Jiang, 2022).
  - Disaggregate NBFIs further to address sectoral heterogeneity (e.g., insurance vs. investment funds).



Conclusion

- This paper provides comprehensive evidence on how macroprudential tightenings affect systemic risk in a world where nonbanks become more important.
- Effectiveness of macroprudential policy is hampered by unregulated actors.
- A very thorough paper with convincing results.
- Timely question, important contribution, relevant for academia and industry alike.
- Look forward to seeing the paper in print!