



TOPICS:

Banking System

SOURCE:

European Central Bank and European Systemic Risk Board

ECB and ESRB Issue Joint Report Analysing Financial Stability Risks from Linkages Between Banks and the Non-Bank Financial Intermediation Sector

- The ECB/ESRB report analyses financial stability **risks arising from linkages between euro area banks and the non-bank financial intermediation (NBFI) sector**, focusing on funding, credit and derivatives interconnections. It highlights that while risks have partly migrated outside the traditional banking system, **interdependencies may amplify systemic stress**.
- A central finding is that euro area **banks are net borrowers from NBFIs**. Approximately 15% of bank balance sheets are funded by NBFI entities, primarily via deposits, repos and short-term debt securities. This funding is often short-term, concentrated and partly denominated in US dollars, exposing banks to roll-over and liquidity risk during market stress. Repo funding from NBFIs has grown significantly since 2021 and is highly concentrated among large banks, particularly G-SIBs, with most transactions non-centrally cleared. Commercial paper markets, heavily reliant on money market funds, present additional run risk, as evidenced during the COVID-19 “dash-for-cash.”
- On the asset side, **banks’ credit exposures** to potentially leveraged NBFIs - such as hedge funds and real estate funds -

- are more limited (around 10% of assets) but growing. Reverse repo lending to hedge funds, often in US dollars, has doubled in recent years. Although typically collateralised, these exposures may transmit shocks via margin calls and asset fire sales. Lending to NBFIs investing in illiquid assets (e.g. commercial real estate) appears smaller but could generate credit losses under adverse scenarios.
- **Derivatives markets** constitute an additional spillover channel. Euro area G-SIBs play a central intermediary role in repo and derivatives markets, concentrating intermediation risk and creating substitutability concerns. During stress, banks may retrench or raise margins, potentially amplifying procyclical dynamics.
- The report underscores significant **data gaps** - particularly regarding non-EU NBFIs and granular balance sheet information - which constrain risk assessment. It concludes that adequate capital and liquidity buffers at systemically important banks are critical to ensure resilience and prevent amplification of shocks across the bank-NBFI nexus.