Private assets and NBFI: opportunities and challenges

The session focused on the evolving role of non-bank financial institutions (NBFIs) and private credit in financial intermediation. Discussions explored their contribution to financing the real economy, associated financial stability risks, and the implications of increasing interconnectedness across the financial system. Particular attention was given to liquidity dynamics, market-based finance, and the role of supervisory frameworks.

1. Reframing financial intermediation: NBFIs, private credit and financial stability

This section sets the conceptual framework of the discussion, focusing on the evolving role of NBFIs and private credit, and their implications for financial stability.

1.1 Setting the scene: NBFIs, private credit and rising liquidity concerns

The Chair highlighted that the discussion would cover the broad topic of two areas of interest: the non-bank financial institution (NBFI) framework representing market-based finance, and private credit related to private markets. Newspapers have recently raised concerns about the need for an industry 'reset', particularly with regard to liquidity conditions and vulnerabilities. 10-year bond yields have reached their highest levels in years: the highest since 2011 in Germany, since 2007 or 2008 in the UK, and since 1996 in Japan.

1.2 Rethinking financial stability: the role of non-regulated finance and constructive failure

1.2.1 Scope and objective: NRFI and a redefinition of financial stability

An industry representative stated that 'NRFI' was a more appropriate term, where the 'R' stands for 'regulated', thus emphasising non-regulated financial intermediation rather than non banking intermediation. The concept of financial stability could be refined to focus more narrowly on stability within the regulated financial system. The aim should not be to eliminate all failures or losses, since encountering failures is essential for upholding market discipline, and ensuring that resolution and recovery frameworks function as intended.

1.2.2 Implications: interlinkages, expectations and system resilience

An industry representative explained that priority should be given to understanding the link between the regulated and non-regulated sectors, given that comprehending the non-regulated field completely may be impractical. Managing public expectations is important, particularly in relation to the media's response to failures in non-regulated areas. Such events should not be viewed as lapses by supervisors or regulators; losses driven by market development could be advantageous if they do not disrupt the integrity of the financial system.

Failures could have positive consequences, strengthening system resilience and providing various funding sources that are essential for the growth of European and Japanese economies. The value of risk transfer channels and investment opportunities resulting from NRFIs and private assets is significant, as they are set to strengthen the regulated financial system.

1.3 Bank-centric systems and evolving roles in market-based finance

1.3.1 Structure and dynamics: the role of banks and NRFI interlinkages

A Central Bank official agreed with the concept of 'NRFI'. It is crucial to strike a balance between financial stability and growth and innovation. The primary implication should be on the interlinkages between regulated banking institutions and NRFIs, or NBFIs. Japan's financial system is bank centric, similar to systems in Italy and France, where banks play a pivotal role in financial intermediation. In Japan, an NBFI usually refers to institutional investors such as insurance companies. This differs from the broader international understanding, which includes non-regulated financial intermediation. Compared to the US, entities such as private credit or equity have a smaller presence in Japan.

Japan faces an aging and declining population, and prolonged low interest rates. Banks have taken on risks in order to boost profitability, champion growth industries and rejuvenate regional economies. Japanese banks offer long term loans and guidance to medium risk firms, in order to enhance growth prospects. Banks have been active in intermediation services to stimulate regional economies and hone their ability to evaluate business potential.

1.3.2 Outlook: collaboration, innovation and emerging risks

A Central Bank official stated that there is potential for greater collaboration between banks, private credit providers, private equity firms and investment funds. This could involve combining banks' credit assessment capabilities with the technological expertise and risk-taking capacity of investment funds to support investment growth, including in emerging sectors such as AI. The appetite for improving profitability through AI and quantitative technologies is at an all-time high. Start-ups in areas such as AI have significant financial needs in Japan, with rising demand for funds. Investment funds already possess the necessary expertise. As interconnectivity between banks and NBFIs or NRFIs expands, greater attention must also be paid to the associated risks.

1.4 Financial stability in an interconnected system: risks and the role of private markets

A Central Bank official explained that their organisation takes a symmetric approach to financial stability, assessing whether the financial system can support the real economy in both good times and periods of stress. During the global financial crisis, under stress banks tended to adjust lending decisions based on the strength of their own balance sheets rather than those of borrowers. In an increasingly interconnected financial system where banks fund non-banks, which then lend to the real economy, it is essential to understand how these dynamics evolve.

Greater diversity and competition in the financial system are beneficial, as certain segments of the economy may not be well served by traditional bank lending for commercial or regulatory reasons. However, this also requires a better understanding of how the non-bank financial system, including private credit, behaves under stress and how risks materialise.

Research shows that private markets play a significant role in the UK economy, accounting for around 10% of corporate debt and 10% of employment, representing approximately two to three million jobs. This segment tends to be concentrated in riskier parts of the credit spectrum. Around 33% of corporate credit in the UK is considered riskier, compared with roughly 66% in private markets. This implies that these segments are likely to experience greater stress in adverse conditions.

2. Scaling up market-based finance: private credit, funding capacity and new investment channels

This section examines the growing role of market-based finance in addressing investment needs, with a particular focus on private credit as a source of long-term funding.

2.1 Resilient market-based finance: conditions, risks and the role of intermediaries

An industry representative noted that non-regulated financial institutions could be described as 'lightly-regulated financial institutions', as many funds in Europe are subject to regulatory frameworks, notably under the Alternative Investment Fund Managers Directive (AIFMD) II. There is a need to take a step back and assess how effectively market-based finance can provide long-term and medium-term funding to the real economy. Strong asset-liability management is a key condition for resilience, particularly ensuring appropriate duration matching between assets and liabilities.

Structures that are less prone to runs are vital; closed-end funds, with their relatively permanent pools of capital and moderate levels of leverage, are better suited to providing durable financing. If financing from lightly regulated institutions is to become a meaningful component of corporate funding in Europe, it must demonstrate sufficient resilience.

2.2 Private credit as a strategic source of long-term financing

2.2.1 Financing role: long-term capital, institutional investors and investment needs

An industry representative observed that credit in the economy is ultimately provided by either banks or investors. Strong asset-liability management is essential, regardless of the financing source. Short-term assets should be matched with short-term funding, while long-term assets should be matched with long-term capital. Private credit provides scalable, low-leverage, long-term capital that can complement bank financing. In Europe, private credit has the potential to play a key role in addressing significant investment needs across strategic sectors such as infrastructure, energy and defence. These sectors together represent an estimated funding requirement of €18 trillion.

Institutional investors such as insurers, pension funds and sovereign wealth funds hold approximately $250 trillion in assets. These investors typically have long investment horizons and are therefore well suited to funding long-duration and structured assets. Insurers were cited as a strong example of effective asset-liability management, as they align long-term liabilities with long-term investments.

2.2.2 Market structures and implications: mobilisation of capital, innovation and financial stability

An industry representative stated that existing market structures already facilitate the mobilisation of private capital, notably securitisation, which can attract a broad global investor base with different risk and return profiles. The ongoing discussions in the EU around revitalising the securitisation markets are welcomed. He also referred to asset-backed financing structures, citing Apollo's £4.5 billion loan to EDF for the construction of a nuclear facility as an example of the scale at which private capital can be deployed. Beyond large-scale infrastructure, there is an increasing importance of private credit in supporting start-ups and scale-ups. More asset-heavy sectors such as fintech and green energy are more amenable to financing structures.

The quality of leverage is more important than its quantity. Bank lending to asset managers and private credit funds is typically senior and shorter term, and has historically performed better than many direct bank loans to corporate borrowers. Credit provided by investors can complement the banking system and contribute to meeting Europe's strategic investment needs in a way that supports financial stability.

The Chair acknowledged the topic of retail investment; there have been frequent questions about whether a situation exists where numerous investors wish to withdraw, but find themselves prevented from doing so. 'Semi-liquid structures' is a key term in this context.

2.3 Expanding retail access to private assets: diversification, safeguards and market evolution

An industry representative observed that retail investment currently accounts for only a small proportion of the private credit market. This growth is primarily driven by the increasing need for diversification, particularly given the rising concentration and correlation in public markets. Around 96% of companies with an annual revenue exceeding $100 million in the EU and the UK are privately held, highlighting the importance for investors of gaining exposure beyond publicly listed assets.

There are ongoing global initiatives aimed at expanding retail access to private assets, including interval funds in the United States, European long-term investment funds (ELTIFs) in the EU and long-term asset funds (LTAFs) in the UK. However, private assets are expected to remain a minority allocation within retail portfolios.

3. Managing risks in an interconnected system: liquidity, vulnerabilities and supervisory challenges

This section focuses on the risks associated with an increasingly interconnected financial system, including liquidity vulnerabilities, and discusses the supervisory tools and approaches needed to address them.

3.1 Financial stability in an interconnected system: risks and the role of private markets

3.1.1 Resilient market-based finance: conditions, risks and the role of intermediaries

An industry representative stated that a wide range of structures exists across private credit and structured finance markets, with varying degrees of leverage and risk characteristics. Banks play a critical role in this ecosystem by providing short-term liquidity and acting as key intermediaries. Their funding models, regulatory oversight and access to central bank liquidity make them well placed to support these channels. Some parts of the private credit market are likely to face challenges as part of the normal process of market discipline. Such episodes can reveal weaknesses in underwriting standards and enable investors to learn from past mistakes.

There are concerns regarding governance and oversight, particularly in relation to retail investor participation. The segment is better suited to institutional investors, given the importance of maintaining stable funding structures and effective asset-liability matching. Greater retail participation could introduce additional risks and undermine the resilience of these funding models, particularly if it weakens the alignment between asset duration and investor liquidity expectations.

3.1.2 Semi-liquid private credit: liquidity risks, market developments and structural vulnerabilities

An industry representative stated that business development companies (BDCs) and similar open-ended fund structures in Europe represent a small part of the total private credit market. While these structures offer the advantage of enabling continuous fundraising, they also introduce higher redemption risks. Concerns have emerged on overexposure to certain software assets with a high risk of obsolescence, with evidence of concentration in some perpetual BDCs and open-ended funds exposed to companies with a relatively low tangible net worth.

There is a growing preference among investors for liquidity, driven by geopolitical tensions, including the conflict in Iran. Unlike in the US, where open-ended funds are increasingly driven by retail investors, European open-ended funds remain predominantly oriented towards institutional investors, such as pension funds and insurance companies. These investors typically have longer investment horizons and greater stability.

The competitive landscape for semi-liquid funds in Europe is evolving, with efforts being made to mitigate liquidity risks. Failure to meet redemption requests beyond quarterly limits can generate headline risk for fund managers and affect their ability to raise capital in the future. Sustained high tender requests may also put pressure on credit profiles and raise concerns about the quality of the remaining assets in investment vehicles, particularly if the higher quality assets are sold first. Weaknesses are likely to emerge in some retail-oriented semi-liquid products. Maintaining strong asset-liability duration matching is critical to ensuring that these vehicles continue to serve as a source of sustainable long-term funding.

3.1.3 Stress conditions: liquidity management and lessons from semi-liquid structures

A Central Bank official noted that the system is still in a period of stress and cautioned against drawing premature conclusions before these dynamics have fully played out. Liquidity management mechanisms in parts of the market such as BDCs appear to have functioned broadly as intended. There has been no widespread evidence of forced asset sales or disorderly fund wind-downs, and tools such as redemption limits have been used effectively.

Consistent application of liquidity management tools is essential for maintaining investor confidence. Clear communication with investors is essential, particularly with regard to how these tools operate in times of stress. Valuation practices must evolve to ensure investors receive sufficiently frequent and reliable information on asset values. While certain mechanisms such as notice periods can give funds time to manage liquidity, they do not resolve underlying mismatches between assets and liabilities. Conversely, tools such as redemption limits may be more effective in managing liquidity pressures in semi-liquid structures.

Additional measures used during periods of stress, such as sponsor support or increased flexibility, may stabilise funds in the short term but could misalign investor expectations if applied inconsistently. The priority is to understand how different market participants behave under stress, and how their interactions may either absorb or amplify shocks within an increasingly interconnected financial system.

3.2 Expanding retail participation in private assets and related safeguards

An industry representative noted that semi-liquid structures, including interval funds and private credit vehicles, are designed with safeguards aligned to the liquidity profile of the underlying assets. These include structured redemption mechanisms and limits that help ensure orderly liquidity management. Non-traded BDCs in the US typically offer quarterly liquidity of around 5% through tender programmes. These limits should be viewed as a protective feature rather than a constraint, as they help to align fund liabilities with the characteristics of the underlying assets.

Professional advice and portfolio-level management is important. Retail investors typically access these products through intermediaries who assess asset allocation and liquidity needs. Understanding the liquidity profile of investments is essential for investors. As retail access to private markets increases, more frequent, transparent and reliable valuation mechanisms will be required to ensure fair pricing when entering and exiting the market.

3.3 Interconnections and systemic implications across financial sectors

3.3.1 Bank-NBFI interconnections: transparency, discipline and the need for coordinated supervision

A Central Bank official observed that the connections between the banking sector and NBFIs are well-established and not necessarily problematic, as they can facilitate risk diversification. However, a lack of transparency can lead to mistrust and uncertainty in the market. Banks are heavily involved in private market credit via various channels, resulting in a symbiotic relationship between banks and NBFIs. Banks provide funding, leverage, structuring and risk management services, and can contribute discipline to these markets.

The objective should not be to extend bank style regulation to all market participants, but rather to understand how banks interact with these actors better and contain risks arising from private credit and broader NBFI activities. Given the growing complexity of financial markets and the presence of large actors operating across multiple segments, there is a need for stronger coordination between banking, insurance and capital market supervisors. Entity-based and activity-based approaches are needed to ensure that regulatory frameworks effectively capture risks wherever they arise, while remaining adaptable to financial innovation.

3.3.2 From regulation to systemic relevance: the evolving role of insurers in an interconnected financial system

A regulator observed that the term 'NBFI' encompasses a wide range of entities and has evolved from the earlier concept of 'shadow banking', which initially excluded insurance. However, over time, the insurance sector has become an integral part of the discussion. The insurance sector is already heavily regulated. The upcoming Solvency II review will introduce additional liquidity risk provisions and enhanced supervisory powers within the EU. At the same time, there is a potential systemic relevance of insurers, particularly as financial interconnections increase. Given current exposures, disruptions in the banking sector could impact insurers more significantly than vice versa. The growing share of certain asset classes on insurers' balance sheets has raised concerns at an international level, including in discussions with UK counterparts.

3.4 Enhancing risk monitoring: stress testing, data and supervisory tools

3.4.1 System-wide stress testing: understanding behaviour, interconnections and systemic risk

A Central Bank official observed that there has been a shift towards more system-wide stress testing approaches in recent years. The focus of current efforts is increasingly on private markets. Their organisation is conducting a stress-testing exercise involving around 50 participants, with the aim of identifying the interconnections between private market actors, banks, insurers and the real economy. The exercise is intended to provide a clearer understanding of how stress scenarios may propagate across the financial system. A key objective of this work is to gain a better understanding of how participants behave under stress conditions.

Traditional top-down stress-testing frameworks usually depend on assumed behaviours, because they cannot observe how firms actually respond in real time. By engaging directly with market participants, the exercise aims to identify the sequence of actions firms would take in response to stress and how these decisions would interact across different institutions. Understanding these interactions is critical to assessing whether behaviours across the system help to absorb shocks or amplify them. This approach aims to improve the identification of systemic vulnerabilities and strengthen the financial system's resilience.

3.4.2 Addressing data gaps in NBFI exposures: cross-border risks and supervisory innovation

A Central Bank official identified Japan as a key market for major NBFI investment funds. The main issue is managing risks related to cross-border transactions. It is difficult to access reliable data on exposure to overseas investment funds; a SWES-type approach could be adopted, though there are limitations of that framework in jurisdictions without direct access to foreign funds.

The Bank of Japan and Japan FSA had recently conducted an 'NBFI fire drill' exercise. Many banks had been asked to report aggregated data on their exposures to NBFIs within three working days. This data had to be broken down by product and fund type. Participants had been required to explain their data collection and aggregation processes. The exercise aimed to evaluate the availability of relevant data and the operational capacity of banks to collect and process that information in stressful situations. Improved information sharing among various stakeholders would more broadly enhance the analysis of macro-financial risks.

3.4.3 Supervisory priorities: stress testing, data, and cross-sector coordination in a changing risk environment

A regulator highlighted the European Commission's aim to encourage a shift in household savings towards investment, including through increased retail participation, to support financing in the EU economy. Top-down, cross-sectoral stress-testing approaches are vital, supported by clearly defined objectives, appropriate modelling frameworks and effective data sharing. However, stress testing alone cannot address regulatory gaps, and should be complemented by broader supervisory coordination.

Asset-intensive reinsurance is an emerging area of interest, particularly outside the EU. This involves the transfer of both market and biometric risks, and requires tailored stress-testing approaches due to the limitations of standard methodologies. Although exposures to such assets remain relatively limited within the EU, there has been a gradual increase.

The increasing interconnectedness of financial sectors requires closer cooperation between supervisors and better integration of banking and insurance expertise, to ensure that emerging risks are understood and addressed properly without constraining market development.