Safeguarding the financial system's spare tyre: regulating non-bank retail lenders in the digital era[1]

Executive summary

Non-bank financial intermediaries (NBFIs) comprise a range of entities with various business models that play a critical role in the financial system. The universe of NBFIs includes all financial intermediaries that are not banks. They encompass firms that are subject to traditional financial sector regulation, such as insurers and securities firms, as well as non-bank lenders that may be subject to a patchwork of regulatory rules. According to the Financial Stability Board (FSB), NBFIs held 47.2% of total global financial assets at year-end 2022 (FSB (2023)).

Those NBFIs that provide private credit to households and small and medium-sized enterprises (SMEs) merit special policy attention, as they complement and sometimes compete with banks in lending to the real economy. We refer to such entities as "NBFI retail lenders". This subsector includes traditional non-bank lenders, such as finance companies and mortgage lenders, as well as newer entrants, such as fintech and big tech lenders.

NBFI retail lenders pose both opportunities and risks. They can provide financial services to underserved and unserved market segments, helping to expand financial inclusion and improve consumer outcomes. They also provide a vital alternative to bank financing, thus diversifying the supply of retail credit. However, some NBFI retail lenders can accept public deposits and/or other forms of retail funding, blurring the bank/non-bank divide. NBFI retail lenders that rely on institutional funding are particularly exposed to maturity transformation risks and may have great interconnectedness with the banking sector. In addition, the scale of NBFI retail lenders' activities is significant in some jurisdictions, which may contribute to the buildup of macro-financial imbalances during cyclical upswings.

The entry of fintechs and big techs into the retail lending market poses additional challenges. NBFI retail "digital only" lenders introduce risks that may not be present in traditional retail lending or may pose elevated risks that are not fully captured through existing regulation. These risks stem from their: (i) use of digital delivery channels; (ii) reliance on alternative data in loan origination, in some cases mined from their affiliated financial or non-financial business; and (iii) novel credit offerings, such as buy now, pay later (BNPL) products. NBFI retail lenders may also be part of broader groups that conduct other financial activities that may fall outside the regulatory perimeter.

This paper takes stock of regulatory frameworks that are applicable to NBFI retail lenders and proposes a methodology to strengthen their prudential oversight. As such, it complements the considerable work conducted by the FSB on assessing and addressing the risks and vulnerabilities posed by NBFIs. Drawing on responses to a Financial Stability Institute (FSI) survey covering 20 jurisdictions, together with a review of relevant publications, we examine a range of regulatory regimes applicable to NBFI retail lenders and propose a holistic approach to enhance effectiveness.

NBFI retail lenders are subject to a patchwork of regulatory approaches. These range from extending all or some aspects of the prudential framework for banks to NBFI retail lenders, to focusing mainly on the conduct of business and consumer protection. The most common approach involves the use of bespoke regimes that vary across and within jurisdictions. In jurisdictions where deposit-taking NBFIs operate, such entities are typically restricted from offering current accounts/demand deposits,

[1] Johannes Ehrentraud (johannes.ehrentraud@bis.org) and Raihan Zamil (Raihan.Zamil@bis.org), Bank for International Settlements; Ségolène Mure (Segolene.Mure@banque-france.fr), Bank of France; and Elisabeth Noble (Elisabeth.Noble@eba.europa.eu), European Banking Authority. We are grateful to Rodrigo Coelho, Camille Graciani and Lindsey Leposke for their helpful comments. Theodora Mapfumo provided valuable administrative support.

signalling how authorities differentiate deposit-taking NBFI retail lenders from banks. Deposit-taking NBFIs and NBFI mortgage lenders are generally subject to more stringent requirements than other NBFI retail lenders. In addition, only a few jurisdictions have extended their regulatory regimes to encompass group-wide supervision of new types of financial and mixed activity groups, while only one surveyed authority extends macroprudential measures to its universe of NBFI retail lenders.

Surveyed jurisdictions share common challenges in determining whether, and if so which, prudential regimes should apply to NBFI retail lenders. First, data gaps on the nature and significance of NBFI retail lending activities – including their interconnectedness with the banking sector – can impede efforts to determine an appropriate policy stance. Second, most jurisdictions take a piecemeal, rather than systematic approach to the prudential oversight of NBFI retail lenders. In addition to data gaps, this may be due to the dispersion of responsibilities among domestic authorities that oversee NBFI retail lenders; and the advent of novel credit products, business models and group structures.

A holistic approach, which involves three key components, can help to guide the prudential oversight of NBFI retail lenders and mitigate regulatory arbitrage risks. These components are: (i) a framework to inform the microprudential oversight of NBFI retail lenders; (ii) a reassessment of group-wide supervision frameworks; and (iii) the creation of enabling institutional arrangements to facilitate day-to-day supervision and to support the wider application of macroprudential measures to NBFI retail lenders.

The microprudential oversight of NBFI retail lenders can benefit from broad-based and targeted policy measures. Broad-based prudential measures, including various financial and operational resilience requirements, may be needed if the NBFI retail lender is either deemed "significant" or can accept retail deposits or their functional equivalent. In addition, certain NBFI retail lending activities may have a significant bearing on consumer welfare that warrant more targeted measures. These include: (i) mortgage lending, given it is the largest financial liability for most consumers; (ii) new products such as BNPL and wage advance credit that may pose specific risks for consumers; and (iii) technology-enabled business models that elevate or introduce new risks for consumers.

The rise of new types of financial and mixed activity groups may require authorities to reassess if existing frameworks remain fit for purpose. While financial groups led by banks, insurers and securities firms are typically subject to group-wide supervision, this is not the case for financial groups comprising other types of financial institutions, including those with two or more NBFI retail lenders. Similarly, international approaches for the supervision of conglomerates were devised prior to the advent of big techs' and fintechs' entry into the financial sector (BCBS (2012)) and apply only if a financial or non-financial group controls companies that conduct material financial activities in two or more sectors (eg banking, insurance or securities). Groups that (i) include NBFI retail lenders and payment providers; and (ii) are owned by big techs and fintechs typically do not fall within scope. These new structures that blend financial services, data and technology call for international bodies to modernise group-wide supervision frameworks that are relevant for the digital era.

Suitable institutional arrangements can facilitate the micro and macroprudential oversight of NBFI retail lenders and new forms of financial conglomeration. NBFI retail lenders that fall under the scope of broad-based prudential measures should, ideally, be subject to oversight by the national prudential regulator, while more targeted prudential requirements may need the involvement of either the prudential or conduct regulator (or both). In addition, new group structures may raise issues that encompass various policy domains – eg prudential, conduct of business, data privacy, operational resilience and competition – that require enhanced cooperation among relevant authorities. Lastly, appropriate institutional arrangements can help support the broader application of macroprudential measures to encompass NBFI retail lenders.