

Michelle W Bowman: When regulation reshapes markets - the migration of corporate lending

Speech by Ms Michelle W Bowman, Vice Chair for Supervision of the Board of Governors of the Federal Reserve System, at the Hoover Institution Annual Monetary Policy Conference, Stanford, California, 8 May 2026.

* * *

Good afternoon and thank you for the invitation to join you at the Hoover Institution's annual Monetary Policy Conference.¹ As the Federal Reserve's Vice Chair for Supervision, I oversee the safety and soundness of banking institutions, responsibilities that are closely linked to another of the Fed's important duties, which is to safeguard financial stability. Instead of talking about monetary policy, my remarks will focus on this topic.

Today, I will address a challenge that emerges at the intersection of these two responsibilities. That is, when regulatory requirements become disproportionately burdensome relative to risk and banks simply curtail the targeted activities. This leaves a deficit between demand for banking services and banks that are willing to provide them. When banks are no longer willing to provide specific services, nonbanks step in to meet those needs, and the activity is essentially pushed out of the regulated banking system.

This includes the migration of corporate lending from banks to nonbanks. Therefore, my remarks will focus on private credit funds, and business development companies (BDCs), and will consider the circumstances that lead to this outmigration, the implications of banks exiting these services, and the Federal Reserve's policy response.

The Recent Growth of Nondepository Financial Institution Corporate Lending

Over the past ten years, we have seen a shift in how credit reaches businesses in the real economy. Since 2015, the bank share of corporate lending decreased from 48 percent to 29 percent in 2025. The private credit market is a significant driver of this shift. In the United States, the private credit market has grown significantly and currently accounts for about \$1.4 trillion, similar in size to both the leveraged loan market and the high-yield bond market. But despite its recent rapid growth, private credit is still a small fraction of overall corporate borrowing in the U.S.-making up only about 10 percent.

There is no mystery about what drove the shift in corporate lending away from banks.² While post-2008 financial crisis reforms strengthened bank capital and liquidity-which were necessary to promote the safety and soundness of banks and U.S. financial stability-they did so with unintended consequences. Attempts to address legitimate gaps resulted in some requirements becoming excessive relative to underlying risk, forcing banks to pare back on some corporate lending activities or to raise the cost of credit to borrowers.

The effects of the current framework become clear when we examine the incentive structure that it creates. Current capital rules create a perverse incentive-ironically, banks receive a more favorable treatment for lending to private credit funds than for lending directly to creditworthy corporations. This treatment encourages banks to finance intermediaries rather than directly serve end-borrowers.

Understanding the Nondepository Financial Institution Ecosystem

The broad definition of nondepository financial institution (NDFI) includes an array of diverse entities like private credit funds, BDCs, insurance companies, private equity firms, and broker-dealers. These entities differ in terms of the types of lending they offer, the effectiveness of their underwriting and risk management, their ability (or inability) to work with borrowers under stress, the stability of their funding sources, and their connections to the banking system. NDFIs also rely on diverse funding structures, with private credit funds and some BDCs primarily attracting capital from institutional investors including pension funds and insurance companies, and with other BDCs providing access to retail investors.

NDFIs are also interconnected with the regulated banking sector through bank loans that typically include revolving credit lines and term loans. Over the past decade, growth in bank lending to NDFIs has outpaced growth in all other bank loan categories.

Emerging Risks and Vulnerabilities

Recent bankruptcies that imposed losses on banks and NDFIs have raised concerns about the quality of loans made by private credit providers. More recently, worries about exposures to industries vulnerable to the implementation of AI, such as the software sector, have compounded these concerns.

We have already seen one potential channel for the transmission of risk within the financial system-the withdrawal of private credit funding sources. As a result of private credit losses, and the failure to achieve targeted investment returns, some private credit funds have experienced a wave of redemptions, concentrated among BDCs that offer investors limited redemption rights.

Despite these redemptions, banks have continued to extend credit to BDCs and other private credit vehicles, with loan commitments and outstanding amounts growing significantly over the past year.³ These loans generally appear to be well collateralized, which should help protect against bank losses in the event of borrower distress or default. Even though NDFIs generally lend to riskier borrowers, default and loss rates would need to be abnormally high for banks to be at risk.

Three-Part Regulatory Response

Recognizing these challenges, let's turn now to the Federal Reserve's approach. Our current approach relies on three complementary pillars.

First, recently proposed changes to the Basel III framework address the punitive capital treatment imposed on traditional bank lending activity.⁴ Unfortunately, the banking regulatory and supervisory framework has created an environment in which traditional bank lending activity has migrated outside of the banking system to nonbanks. In the case of mortgage lending, our priority is to ensure that our capital regulations better align bank capital requirements with risk across multiple asset classes.⁵ For bank lending to corporations and businesses, the proposal would generally reduce the risk weight from 100 percent to 65 percent for corporates considered to be investment grade by the lending bank. These changes in the capital proposals will reduce the gap in risk weights between loans to nonfinancial businesses and loans to nonbank financial corporations.

This will increase competition in ways that benefit borrowers and reduce risks to financial stability. The proposal enables banks to compete more effectively with NDFIs in serving creditworthy businesses. When banks receive a more favorable treatment for lending to private credit funds than for lending directly to creditworthy corporations, it can result in an undersupply of credit to traditional bank business borrowers. By properly calibrating capital requirements, we can allow banks to more effectively compete in providing credit to private businesses. Banks have deep experience underwriting loans to these borrowers and should not be excluded from serving their customers to meet this market demand. To be clear, the capital proposal maintains the strong banking sector capital while ensuring that regulatory requirements do not lead to activities leaving the regulated banking sector.

Second, our approach recognizes that addressing the inappropriate risk weighting of certain activities doesn't mean eliminating private credit from the market. There is a role for both banks and NDFIs in providing credit to private companies. NDFIs serve legitimate functions through their specialization in narrow market segments, speed of origination, and flexibility in credit terms. They are well-suited to provide long-term loans to borrowers that may be unsuitable for banks—typically, smaller and riskier borrowers—financed with locked-in capital from institutional investors. BDCs, for instance, make most of their loans at spreads of 400 basis points or more, whereas large banks make most of their loans at 200 basis points or less.

The optimal outcome preserves this division of credit provision. Private credit funds and banks can effectively serve different parts of the market. The long-term relationships banks have established with corporate clients gives them an advantage in underwriting and monitoring loans for their traditional customers. Banks are funded primarily by depositors and providers of short-term wholesale funding. NDFIs have different expertise and may have a greater tolerance for risk. Their model relies on funding from investors who accept relative illiquidity in exchange for higher expected returns.

The question is not whether NDFIs should exist. Instead, we should ensure that the regulatory framework does not tilt the playing field to push activity outside of the regulatory perimeter for reasons unrelated to risk or efficiency. Some lending by nonbanks is riskier and is better kept outside of regulated financial institutions because it can be funded by investment structures that rely on more stable funding and less

leverage. But when creditworthy businesses that could be served by banks instead turn to private credit primarily because of excessive regulatory burden, we should consider whether our rules are appropriately calibrated.

Finally, even as the Fed seeks to level the playing field and preserve complementary roles for different segments of finance, we should improve our ability to understand the connections between these segments. One approach is to provide more transparency through regulatory reporting. Measuring and monitoring risks in bank lending to NDFIs requires effective supervision and data that can be collected through regulatory reporting. Our current data reporting relies on industry classification codes that are too broad to effectively measure these specific exposures.

The current industry code for "Other Financial Vehicles" includes hedge funds, private equity funds, private credit funds, BDCs, special purpose entities, and asset-backed security issuers-without further distinction. This lack of granularity makes it difficult to assess concentration risks, measure interconnectedness, or calibrate capital requirements to actual risk.

Therefore, the Board will update our regulatory reporting to ensure that supervisors have transparency into bank lending to NDFIs. The update requires the largest banks to report financial information about NDFIs to which they extend credit, including total assets, net income, and leverage that enable an analysis of credit underwriting and ongoing risk assessments.

This enhanced transparency also supports other policy objectives. It will provide a better understanding of the risks associated with bank lending to NDFIs relative to other types of bank lending. It will ensure that supervisory stress test models are appropriately calibrated for these exposures, which will also benefit activities and processes related to capital planning. It will allow supervisors to independently evaluate risks and assess the condition of these borrowers on an ongoing basis. This can increase consistency and eliminate the need for ad hoc data collections and other on-site supervisory efforts.

Looking Ahead: Principles for Financial Stability

These three elements-recalibrated capital requirements, preserved complementary roles for different segments of finance, and targeted data collection-are part of an integrated approach to supervision that serves multiple objectives.

An approach that supports economic growth by enabling banks to deploy capital efficiently supports financial stability by improving risk monitoring of bank investments in NDFIs. And it maintains safety and soundness by ensuring that banks remain well capitalized, providing supervisors with necessary information to comprehensively assess risks. Together, these create a more efficient, stable financial system where banks return to providing traditional banking activities and credit, and other risks migrate to entities and investors better suited to bear them.

Closing Thoughts

As we consider these issues, we should remember that regulation always involves choices and tradeoffs. The Federal Reserve's approach represents an evolution in supervision and regulation. We recognize the changing landscape of credit intermediation, but preserve our commitment to safety and soundness. By calibrating capital requirements more closely to actual risk, we enable banks to compete on a more level playing field with nonbank lenders in serving creditworthy borrowers. Through targeted data collection, we can better understand and effectively supervise these relationships and their inherent risks.

I will conclude by saying that I look forward to working together with my federal banking agency colleagues, as we continue to refine our approach to modernizing supervision of this evolving landscape.

¹ The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

² The migration in corporate lending has been documented in academic literature. See, for example, Tetiana Davydiuk, Tatyana Marchuk, and Samuel Rosen, "Direct Lenders in the U.S. Middle Market," *Journal of Financial Economics* 162 (2024), <https://doi.org/10.1016/j.jfineco.2024.103946>; Sergey Chernenko, Isil Erel, and Robert Prilmeier, "Why Do Firms Borrow Directly from Nonbanks?," *The Review of Financial Studies* 35, no. 11 (2022): 4902–47, <https://doi.org/10.1093/rfs/hhac016>; Rustom M. Irani, Rajkamal Iyer, Ralf R. Meisenzahl, and José-Luis Peydró, "The Rise of Shadow Banking: Evidence from Capital Regulation," *The Review of Financial Studies* 34, no. 5 (2021): 2181–2235, <https://doi.org/10.1093/rfs/hhaa106>.

³ See Board of Governors of the Federal Reserve System, [*Financial Stability Report*](#).

⁴ See Board of Governors of the Federal Reserve System, "[Agencies Request Comment on Proposals to Modernize the Regulatory Capital Framework and Maintain the Strength of the Banking System](#)," press release, March 19, 2026.

⁵ Michelle W. Bowman, "[Revitalizing Bank Mortgage Lending, One Step with Basel](#)," speech delivered at the American Bankers Association 2026 Conference for Community Bankers, Orlando, FL, February 16, 2026.